# 2016
# LATVENERGO AS ANNUAL REPORT

# CONTENT



## FINANCIAL CALENDAR

Interim Condensed Financial Statements:

for the 3 months of 2017 (unaudited) – **31.05.2017.**

for the 6 months of 2017 (unaudited) – **31.08.2017.**

for the 9 months of 2017 (unaudited) – **30.11.2017.**

*** The Financial Statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU**

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# KEY FIGURES

## Financial figures

| | 2016 | 2015 | 2014* | 2013* | 2012* |
|---|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| Revenue: | 513,563 | 521,146 | 564,550 | 809,575 | 819,459 |
| Including electricity sales | 386,670 | 381,702 | 409,542 | 640,233 | 645,072 |
| heat sales | 71,093 | 81,545 | 96,812 | 104,161 | 113,387 |
| EBITDA [1] | 241,606 | 180,982 | 105,052 | 121,007 | 126,024 |
| Operating profit [2] | 141,071 | 90,475 | 18,158 | 27,880 | 51,891 |
| Profit before tax [3] | 156,290 | 103,212 | 35,045 | 29,928 | 53,394 |
| Profit | 137,441 | 94,750 | 34,800 | 25,659 | 44,367 |
| Dividends[11] | 90,142 | 77,413 | 31,479 | 23,605 | 40,617 |
| Total assets | 3,204,394 | 3,124,054 | 3,104,592 | 3,231,169 | 3,217,674 |
| Non-current assets | 2,626,560 | 2,638,048 | 2,634,150 | 2,678,442 | 2,718,671 |
| Total equity | 2,177,069 | 2,114,900 | 2,047,666 | 2,042,434 | 2,047,660 |
| Borrowings | 778,323 | 782,965 | 810,681 | 921,370 | 836,296 |
| Net debt[4] | 597,126 | 681,146 | 721,715 | 676,616 | 603,746 |
| Net cash flows from operating activities | 201,428 | 174,797 | 94,604 | 9,097 | 90,653 |
| Capital expenditure | 79,913 | 78,694 | 52,465 | 66,627 | 140,874 |

## Financial ratios

| | | 2016 | 2015 | 2014* | 2013* | 2012* |
|---|---|---|---|---|---|---|
| EBITDA margin [5] | % | 47 | 35 | 19 | 15 | 15 |
| Operating margin [6] | % | 27.5 | 17.4 | 3.2 | 3.4 | 6.3 |
| Profit before tax margin [7] | % | 30.4 | 19.8 | 6.2 | 3.7 | 6.5 |
| Profit margin [8] | % | 26.7 | 18.2 | 6.2 | 3.2 | 5.4 |
| Return on assets (ROA) [9] | % | 4.3 | 3.0 | 1.1 | 0.8 | 1.4 |
| Return on equity (ROE) [10] | % | 6.4 | 4.6 | 1.7 | 1.3 | 2.2 |
| Net debt / equity | % | 27 | 32 | 35 | 33 | 29 |

## Operational figures

| | | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|
| Retail electricity supply in Latvia | GWh | 5,204 | 5,329 | 5,636 | 5,873 | 6,708 |
| Electricity generation | GWh | 4,660 | 3,833 | 3,577 | 4,811 | 5,040 |
| Thermal energy generation | GWh | 2,422 | 2,179 | 2,312 | 2,310 | 2,452 |
| Number of employees | | 1,472 | 1,464 | 1,439 | 1,426 | 1,380 |
| Moody's credit rating | | Baa2 (stable) | Baa2 (stable) | Baa3 (stable) | Baa3 (stable) | Baa3 (stable) |

* all financial figures for 2012 – 2014 remeasured according to IFRS principles

[1] EBITDA – earnings before interest, income tax, share of profit or loss of associates and subsidiaries, depreciation and amortisation, and impairment of intangible assets and property, plant and equipment
[2] Operating profit – earnings before income tax, finance income and costs
[3] Profit before tax – earnings before income tax
[4] Net debt – borrowings at the end of the year minus cash and cash equivalents at the end of the year
[5] EBITDA margin – EBITDA / revenue
[6] Operating margin – operating profit / revenue
[7] Profit before tax margin – profit before tax / revenue
[8] Profit margin – profit / revenue
[9] Return on assets (ROA) – profit / average value of assets (total assets at the beginning of the year + total assets at the end of the year/2)
[10] Return on equity (ROE) – profit / average value of equity (total equity at the beginning of the year + total equity at the end of the year/2)
[11] Dividends to the equity holder of the Company. Dividends are proposed as subject to approval by the Shareholder's meeting (see Note 19 b)

Latvenergo AS is a power supply utility operating in generation and trade of electricity and thermal energy in Latvia. Latvenergo AS is the owner of the following subsidiaries: Sadales tīkls AS (participation share – 100%), Elektrum Eesti OÜ (100%), Elektrum Lietuva, UAB (100%), Latvijas elektriskie tīkli AS (100%), Enerģijas publiskais tirgotājs AS (100%) and Liepājas enerģija SIA (51%).

## EBITDA and profit increased

In 2016 the revenue of Latvenergo AS is EUR 513.6 million (2015: EUR 521.1 million). The decrease in revenue was mainly due to lower thermal energy revenue – EUR 10.5 million, which was influenced by 24% lower average natural gas price compared to the previous year. The EBITDA of Latvenergo AS reached EUR 241.6 million (2015: EUR 181.0 million). The results were positively influenced by 36% higher output from Daugava hydropower plants (hereinafter – HPPs) and lower natural gas and electricity market prices. Comparing to last year the average electricity price in the Latvian bidding area was 14% lower. The profit of Latvenergo AS reached EUR 137.4 million (2015: EUR 94.8 million). Along with the improvement in results, return on equity increased and reached 6.4%, previous year: 4.6%.

In 2016 Latvenergo Group has successfully maintained the leading electricity supplier position in the Baltics. Latvenergo group market share is around 30% (2015: around 32%) of the Baltic electricity market. In 2016, the electricity supplied to the retail customers in Latvia was 5,204 GWh (2015: 5,329 GWh). The decrease in the amount of electricity supplied is primarily related to intensify price competition environment in large business customers segment. The electricity supply volume in Lithuania and Estonia reached 2,376 GWh, which is around 20% higher than the amount provided by competing electricity suppliers in Latvia.

## Electricity generated increased by 22%

In 2016, comparing to last year, the total amount of electricity generated by the power plants of Latvenergo AS increased by 22% reaching 4,660 GWh (2015: 3,833 GWh).

In 2016, electricity output at Riga combined heat and power plants (hereinafter – CHPPs) was increased by 9% reaching 2,206 GWh (2015: 2,025 GWh). The increased generation at Riga CHPPs was fostered by lower natural gas price. Riga CHPPs ensured effective and operative electricity generation thus precluding the risk of electricity price increase in the region. The role of Riga CHPPs was particularly significant during interruption periods in interconnection operation, as well as, at times when there were fluctuations in generation supply and demand in the neighbouring countries.

The generated electricity output at Daugava HPPs was increased by 36% reaching 2,449 GWh (2015: 1,805 GWh). It was fostered by higher water inflow in the Daugava River in the second half of 2016. Due to optimal mix of Latvenergo Group's generation at Riga CHPPs and Daugava HPPs and the opportunities to import, consumers in the Baltic States benefit from both the price convergence to the Nordic price level and the price stability on the long–term.

In 2016, the total amount of thermal energy generated by Latvenergo AS was increased by 11% reaching 2,422 GWh (2015: 2,179 GWh). The increase was determined by comparatively colder weather conditions in January and November.

## Daugava HPPs hydropower unit reconstruction programme is continued

In 2016, the total amount of investments into non–current assets by Latvenergo AS is EUR 79.9 million (2015: EUR 78.7 million). A significant amount was invested in implementation of Daugava HPPs hydropower unit reconstruction programme thereby contributing to environmentally friendly and environmental development projects. In 2016, the amount invested in Daugava HPPs hydropower unit reconstruction was EUR 35.2 million. The programme is scheduled to be completed until 2022, with the estimated total reconstruction costs exceeding EUR 200 million. The reconstruction will provide for further 40–year operation of hydropower units.

## Diversified borrowing sources

Latvenergo AS regularly diversifies sources of borrowed capital to ensure the required funding for investment programme of following years and debt repayment in due term.

In April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million, thus completing the second bond offering programme of EUR 100 million. In October 2016, Moody's Investor Service assigned the highest Green Bond Assessment grade of GB1 (excellent) for the *green* bonds. Moody's Investor Service also assigned a Baa2 (stable) credit rating for the bonds, which corresponds to the credit rating of Latvenergo AS.

As of 31 December 2016, Latvenergo AS borrowings are EUR 778.3 million (31 December 2015: EUR 783.0 million), which includes loans from international investment banks (50% of borrowings), commercial banks (24%) and bonds of EUR 205 million (26%), of which EUR 100 million *green* bonds.

The net debt (borrowings less cash and cash equivalents) of Latvenergo AS decreased to EUR 597.1 million as at the end of the reporting period (31 December 2015: EUR 681.1 million). It improved the net debt to equity ratio, which as at 31 December 2016 was 27% (31 December 2015: 32%).

## Medium term strategy approved

In October 2016, Latvenergo AS Shareholder's Meeting approved the medium term consolidated strategy of Latvenergo Group for 2017–2022. The next period strategy takes into account the expected challenges in the energy industry and foresees strengthening of Latvenergo Group's leading position in core markets and development of the Group in a wider scale by creating new products and promoting the synergy of generation and trade.

Taking into consideration the main challenges within the industry and business environment, three main operational objectives are defined in the strategy:

- Strengthening of sustainable and economically sound market position in core markets (in the Baltics), meanwhile considering a geographic and / or product / service expansion;
- Development of generation portfolio that fosters synergy with trade and that promotes value increase of the Group;
- Development of a customer-driven, functional, safe and efficient network.

Strategy development comprehended detailed industry and operating environment analysis, evaluation of business opportunities, and discussions with industry experts and stakeholders. During the preparation process of the strategy requirements of OECD Guidelines on Corporate Governance of State-Owned Enterprises, Law on Governance of Capital Shares of a Public Person and Capital Companies, and requirements of Guidelines for Drawing up of the Medium-Term Operational Strategy for State-Owned Enterprises approved by Cross-Sectoral Coordination Centre were met.

Along with the approval of the strategy also financial targets of Latvenergo AS were set. Financial targets are divided into three target groups: profitability, capital structure, and dividend policy. The financial targets have been set to ensure:

- Ambitious and at the same time achievable profitability, which is consistent with the average indicators of comparable companies of the European energy industry and ensuring a return proportional to the risk;
- Optimal and industry relevant capital structure that limits the potential financial risks;
- An adequate dividend policy in line with the planned investment policy and the set capital structure targets.

| Target group | Ratio | Year 2022 |
|---|---|---|
| Profitability | Return on equity | > 6% |
| Capital structure | Net debt to equity | < 50% |
| Dividend policy | Dividend payout ratio | > 80% |

## Latvenergo AS Supervisory Board elected

In accordance with the Law On Governance of Capital Shares of a Public Person and Capital Companies, and OECD recommendations, on 16 December 2016, the Shareholder's Meeting of Latvenergo AS elected the Supervisory Board of Latvenergo AS. Its main goal is to enhance efficiency of asset management of the company. The Supervisory Board consists of five independent members: Andris Ozoliņš (Chairman of the Supervisory Board), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis, and Martin Sedlacky. The Supervisory Board is elected for a five-year term.

The Financial Statements of Latvenergo AS for 2016 is prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union. The Company adopted IFRS in accordance with IFRS 1, First–time adoption of International Financial Reporting Standards. The date of transition to IFRS is 1 January 2015.

### *Financial risk management*

Activities of Latvenergo AS are exposed to a variety of financial risks: market risk, credit risk and liquidity risk. The risk management programme of the Latvenergo Group focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of Latvenergo AS. In order to maintain financial stability Latvenergo AS uses various financial risk control and limiting activities, as well derivative financial instruments to hedge certain risk exposures.

Financial risks are managed in accordance with the principles of the Financial risk management policy of Latvenergo Group.

**a) Market risks**

*I) Currency risk*

Foreign currency exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency other than the Company's functional currency.

As of 31 December 2016 all borrowings of the Company were denominated in euros.

In 2016 none of the Company's investments were exposed to substantial foreign currency risk.

Management of Latvenergo AS has set up the Financial Risk Management Policy inter alia to manage the Company's foreign currency exchange risk against functional currency. To manage the Company's foreign currency exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy envisages use of forward contracts.

*II) Interest rate risk*

The Company's interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Company to a risk that finance costs might increase significantly when interest rates rise up. Borrowings from financial institutions mostly have a variable interest rate, comprising 3, 6 or 12 month EURIBOR and a margin. The Company's policy is to maintain at least 35% of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2–4 years.

To hedge cash flow interest rate risk the Company has entered into rate swap agreements with total notional amount of EUR 174.2 million (2015: EUR 221.5 million) (Note 20 c, II). As of 31 December 2016 62% of the total Company's borrowings (31/12/2015: 55%; 01/01/2015: 43%) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.1 years (2015: 2.4 years).

The Company analyses its interest rate risk exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and hedging. Based on these scenarios, the Company calculates the impact on profit or loss as well as on cash flows of a defined interest rate shift.

*III) Price risk*

Price risk is the risk that the fair value and cash flows of financial instruments will fluctuate in the future due to reasons other than changes in the market prices resulting from interest rate risk or foreign exchange risk. The purchase and sale of goods produced and the services provided by the Company under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The electricity price risk is the Company's substantial price risk. The electricity price risk refers to change in market price of electricity, which could have negative impacts on the Company's financial results both because of falling revenue from generation and mismatch between floating market prices and fixed retail prices.

The Company limits the electricity price risk by entering into long–term fixed price customer contracts and by using electricity financial derivatives. Production is hedged gradually until 80%–90% of production sold before the current year. The 2016 production plan was sold at 100% of planned CHPP's generation and 75% of planned HPP's generation by 31 December 2015. The ratio of production hedge is limited by the seasonal production pattern of HPP's production, depending on weather conditions. Since retail portfolio volume exceeds the Company's production volume, the Company uses electricity financial derivatives for hedging purposes.

As of 31 December 2016 the Company has entered into electricity forward and future contracts with total outstanding volume of 2,195,685 MWh (31/12/2015: 2,880,436 MWh; 01/01/2015: 1,144,162 MWh) and notional value of EUR 36.0 million (31/12/2015: EUR 64.1 million; 01/01/2015: EUR 38.0 million).

**b) Credit risk**

Credit risk is managed at the Latvenergo Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, outstanding receivables. Credit risk exposure in connection with trade receivables is limited due to broad range of the Company's customers. The Company has no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics.

Credit risk related to cash and short–term deposits with banks is managed by balancing the placement of financial assets in order to maintain the possibility to choose the best offers and to reduce probability to incur losses. No credit limits were exceeded during the reporting period, and the Company's management does not expect any losses due to occurrence of credit risk.

**c) Liquidity and cash flow risk**

The Company's policy of liquidity and cash flow risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Company's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

The Company's management is monitoring rolling forecasts of the Company's liquidity reserve, which comprises of undrawn borrowing facilities, and cash and cash equivalents.

### *Events after the reporting period*

All significant events that would materially affect the financial position of Latvenergo AS after the reporting period are disclosed in Note 25 of the Company's Financial Statements.

### *Statement of management responsibility*

Based on the information available to the Management Board of Latvenergo AS in all material aspects Latvenergo AS Annual Report 2016 that includes management report has been prepared in accordance with applicable laws and regulations and gives a true and fair view of assets, liabilities, financial position, profit or loss, equity and cash flows of Latvenergo AS. All information included in the Management report is true.

### *Profit distribution*

Fulfilling the requirements of the Article No. 41 of the law "On the State budget 2017" that determines the amount of dividends payable in the year 2017, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 90.1 million, that consists from Latvenergo AS profit of 2016 in the amount of EUR 73.0 million and profit of 2015 in the amount of EUR 17.1 million, and the rest of Latvenergo AS profit of 2016 – EUR 64.4 million to transfer to Latvenergo AS reserves with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2017.

The distribution of profit for 2016 is subject to a resolution of Latvenergo AS Shareholders' Meeting.

**Management Board of Latvenergo AS:**

**Āris Žīgurs**
Chairman of the Management Board

**Guntars Baļčūns**
Member of the Management Board

**Uldis Bariss**
Member of the Management Board

**Māris Kuņickis**
Member of the Management Board

**Guntis Stafeckis**
Member of the Management Board

Riga, 18 April 2017

# FINANCIAL STATEMENTS

## Statement of Profit or Loss

| | Notes | 2016 | 2015 |
|---|---|---|---|
| | | EUR'000 | EUR'000 |
| **Revenue** | 6 | **513,563** | **521,146** |
| Other income | | 3,115 | 1,695 |
| Raw materials and consumables used | 7 | (186,258) | (252,882) |
| Personnel expenses | 8 | (39,165) | (38,321) |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | 12, 13 | (100,535) | (90,507) |
| Other operating expenses | 9 | (49,649) | (50,656) |
| **Operating profit** | | **141,071** | **90,475** |
| Finance income | 10 a) | 12,958 | 14,097 |
| Finance costs | 10 b) | (14,772) | (19,099) |
| Received dividends from subsidiaries | 14 a) | 17,033 | 17,739 |
| **Profit before tax** | | **156,290** | **103,212** |
| Income tax | 11 | (18,849) | (8,462) |
| **Profit for the year** | | **137,441** | **94,750** |

## Statement of Other Comprehensive Income

| | Notes | 2016 | 2015 |
|---|---|---|---|
| | | EUR'000 | EUR'000 |
| **Profit for the year** | | **137,441** | **94,750** |
| ***Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):*** | | | |
| Gains from change in hedge reserve | 19 a) | 2,847 | 4,077 |
| **Net other comprehensive income to be reclassified to profit or loss in subsequent periods** | | **2,847** | **4,077** |
| ***Other comprehensive loss not to be reclassified to profit or loss in subsequent periods (net of tax):*** | | | |
| Losses as a result of re–measurement on defined post–employment benefit plan | 21 a) | (890) | (199) |
| **Net other comprehensive loss not to be reclassified to profit or loss in subsequent periods** | | **(890)** | **(199)** |
| **Other comprehensive income for the year, net of tax** | | **1,957** | **3,878** |
| **Total other comprehensive income for the year** | | **139,398** | **98,628** |

Notes on pages 12 to 61 form an integral part of these financial statements.

**Āris Žīgurs**
Chairman of the Management Board

**Guntars Baļčūns**
Member of the Management Board

**Uldis Bariss**
Member of the Management Board

**Māris Kuņickis**
Member of the Management Board

**Guntis Stafeckis**
Member of the Management Board

**Liāna Ķeldere**
Accounting director

Riga, 18 April 2017

## Statement of Financial Position

| | Notes | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 |
| **ASSETS** | | | | |
| **Non–current assets** | | | | |
| Intangible assets | 12 | 18,769 | 19,846 | 18,687 |
| Property, plant and equipment | 13 a) | 1,322,518 | 1,344,670 | 1,360,664 |
| Investment properties | 13 b) | 72,833 | 71,563 | 70,388 |
| Non–current financial investments | 14 | 817,049 | 817,049 | 817,049 |
| Non–current loans to subsidiaries | 23 f),g) | 377,380 | 362,605 | 338,834 |
| Other non–current receivables | | 977 | 1,706 | – |
| Investments in held–to–maturity financial assets | 20 a) | 17,034 | 20,609 | 28,528 |
| **Total non–current assets** | | **2,626,560** | **2,638,048** | **2,634,150** |
| **Current assets** | | | | |
| Inventories | 15 | 9,118 | 8,377 | 8,742 |
| Prepayments for inventories | 15, 23 c) | 16,693 | 11 | – |
| Trade receivables and other receivables | 16, 23 c), d) | 113,659 | 103,868 | 133,186 |
| Current loans to subsidiaries | 23 g) | 245,324 | 261,972 | 238,940 |
| Deferred expenses | | 2,189 | 2,100 | 608 |
| Investments in held–to–maturity financial assets | 20 a) | 3,520 | 7,859 | – |
| Derivative financial instruments | 20 c) | 6,134 | – | – |
| Cash and cash equivalents | 17 | 181,197 | 101,819 | 88,966 |
| **Total current assets** | | **577,834** | **486,006** | **470,442** |
| **TOTAL ASSETS** | | **3,204,394** | **3,124,054** | **3,104,592** |
| **EQUITY** | | | | |
| Share capital | 18 | 1,288,715 | 1,288,531 | 1,288,446 |
| Reserves | 19 | 650,020 | 649,779 | 645,719 |
| Retained earnings | | 238,334 | 176,590 | 113,501 |
| **Total equity** | | **2,177,069** | **2,114,900** | **2,047,666** |
| **LIABILITIES** | | | | |
| **Non–current liabilities** | | | | |
| Borrowings | 20 b) | 627,691 | 701,822 | 673,817 |
| Deferred income tax liabilities | 11 | 126,260 | 127,899 | 123,102 |
| Provisions | 21 | 7,924 | 6,605 | 5,715 |
| Derivative financial instruments | 20 c) | 7,946 | 8,291 | 11,698 |
| Other liabilities and deferred income | | 1,055 | 1,133 | 749 |
| **Total non–current liabilities** | | **770,876** | **845,750** | **815,081** |
| **Current liabilities** | | | | |
| Trade and other payables | 22, 23 c),e) | 85,569 | 71,289 | 96,087 |
| Deferred income | | 59 | 59 | 39 |
| Income tax payable | | 16,549 | 3,630 | – |
| Borrowings | 20 b) | 150,632 | 81,143 | 136,864 |
| Derivative financial instruments | 20 c) | 3,640 | 7,283 | 8,855 |
| **Total current liabilities** | | **256,449** | **163,404** | **241,845** |
| **TOTAL EQUITY AND LIABILITIES** | | **3,204,394** | **3,124,054** | **3,104,592** |

Notes on pages 12 to 61 form an integral part of these financial statements.

**Āris Žīgurs**
Chairman of the Management Board

**Guntars Baļčūns**
Member of the Management Board

**Uldis Bariss**
Member of the Management Board

**Māris Kuņickis**
Member of the Management Board

**Guntis Stafeckis**
Member of the Management Board

**Liāna Ķeldere**
Accounting director

Riga, 18 April 2017

## Statement of Changes in Equity

| | Notes | Attributable to equity holder of the Company | | | Total |
|---|---|---|---|---|---|
| | | Share capital | Reserves | Retained earnings | |
| | | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **As of 1 January 2015** | | **1,288,446** | **645,719** | **113,501** | **2,047,666** |
| Increase in share capital | 18 | 85 | – | – | **85** |
| Dividends for 2014 | 19 b) | – | – | (31,479) | **(31,479)** |
| Disposal of PPE revaluation reserve | 19 a) | – | (17) | 17 | **–** |
| **Total contributions and profit distributions recognised directly in equity** | | **85** | **(17)** | **(31,462)** | **(31,394)** |
| Profit for the year | | – | – | 94,750 | **94,750** |
| Change in hedge reserve | 19 a) | – | 4,077 | – | **4,077** |
| Re–measurement on defined post–employment benefit plan | 21 a) | – | – | (199) | **(199)** |
| **Total other comprehensive income / (loss)** | | **–** | **4,077** | **(199)** | **3,878** |
| **Total comprehensive income** | | **–** | **4,077** | **94,551** | **98,628** |
| **As of 31 December 2015** | | **1,288,531** | **649,779** | **176,590** | **2,114,900** |
| Increase of share capital | 18 | 184 | – | – | **184** |
| Dividends for 2015 | 19 b) | – | – | (77,413) | **(77,413)** |
| Disposal of PPE revaluation reserve | 19 a) | – | (2,606) | 2,606 | **–** |
| **Total contributions and profit distributions recognised directly in equity** | | **184** | **(2,606)** | **(74,807)** | **(77,229)** |
| Profit for the year | | – | – | 137,441 | **137,441** |
| Change in hedge reserve | 19 a) | – | 2,847 | – | **2,847** |
| Re–measurement on defined post–employment benefit plan | 21 a) | – | – | (890) | **(890)** |
| **Total other comprehensive income / (loss)** | | **–** | **2,847** | **(890)** | **1,957** |
| **Total comprehensive income** | | **–** | **2,847** | **136,551** | **139,398** |
| **As of 31 December 2016** | | **1,288,715** | **650,020** | **238,334** | **2,177,069** |

Notes on pages 12 to 61 form an integral part of these financial statements.

## Statement of Cash Flows

| | Notes | 31/12/2016 | 31/12/2015 |
|---|---|---|---|
| | | EUR'000 | EUR'000 |
| **Cash flows from operating activities** | | | |
| Profit before tax | | 156,290 | 103,212 |
| **Adjustments :** | | | |
| - Amortisation, depreciation and impairment of intangible assets and property, plant and equipment | 12, 13 | 100,535 | 90,507 |
| - Loss from disposal of non–current assets | | 395 | 1,062 |
| - Interest costs | 10 b) | 14,772 | 19,255 |
| - Interest income | 10 a) | (12,931) | (12,750) |
| - Fair value gains on derivative financial instruments | 7, 10 | (7,274) | (901) |
| - Increase in provisions | 21 | 272 | 656 |
| - Received dividends from subsidiaries | 14 a) | (17,033) | (17,739) |
| - Unrealised (losses) / income on currency translation differences | 10 b) | (26) | 27 |
| **Operating profit before working capital adjustments** | | **235,000** | **183,329** |
| (Increase) / decrease in inventories | | (17,423) | 354 |
| (Increase) / decrease in trade and other receivables | | (9,501) | 21,670 |
| Increase / (decrease) in trade and other payables | | 3,594 | (28,015) |
| ***Cash generated from operating activities*** | | ***211,670*** | ***177,338*** |
| Interest paid | | (16,136) | (19,740) |
| Interest received | | 13,306 | 12,633 |
| (Paid) / repaid corporate income tax | | (7,412) | 4,566 |
| **Net cash flows from operating activities** | | **201,428** | **174,797** |
| **Cash flows from investing activities** | | | |
| Loans issued to subsidiaries | 23 f),g) | (78,446) | (165,573) |
| Repayment of loans issued to subsidiaries | 23 f),g) | 80,319 | 118,770 |
| Purchase of intangible assets and property, plant and equipment | | (67,282) | (73,499) |
| Proceeds from investments in subsidiaries | 14 a) | 17,033 | 17,739 |
| Proceeds from redemption of held–to–maturity financial assets | | 7,914 | 69 |
| **Net cash flows used in investing activities** | | **(40,462)** | **(102,494)** |
| **Cash flows from financing activities** | | | |
| Proceeds from issued debt securities (bonds) | 20 b) | 26,266 | 74,893 |
| Proceeds on borrowings from financial institutions | 20 b) | 55,000 | 30,000 |
| Repayment of borrowings | 20 b) | (85,441) | (132,864) |
| Dividends paid to equity holder of the Company | 19 b) | (77,413) | (31,479) |
| **Net cash flows used in financing activities** | | **(81,588)** | **(59,450)** |
| **Net increase in cash and cash equivalents** | | **79,378** | **12,853** |
| Cash and cash equivalents at the beginning of the year | | 101,819 | 88,966 |
| **Cash and cash equivalents at the end of reporting year** | **17** | **181,197** | **101,819** |

Notes on pages 12 to 61 form an integral part of these financial statements.

# Notes to the Financial Statements

## 1. GENERAL INFORMATION ON THE COMPANY

All of shares of public limited company Latvenergo (hereinafter – Latvenergo AS or the Company) are owned by the Republic of Latvia and are held by the Ministry of Economics of the Republic of Latvia. The registered address of the Company is 12 Pulkveža Brieža Street, Riga, Latvia, LV–1230.

Latvenergo AS is power supply utility engaged in electricity and thermal energy generation, as well as sales of electricity. Latvenergo AS is one of the largest corporate entities in the Baltics. According to the Energy Law of the Rupublic of Latvia, Latvenergo AS is designated as a national economy object of State importance and, therefore, is not subject to privatisation.

Latvenergo AS heads the Latvenergo Group that includes the following subsidiaries:

- Sadales tīkls AS (since 18 September 2006) with 100% interest held;
- Elektrum Eesti OÜ (since 27 June 2007) and its subsidiary Elektrum Latvija SIA (since 18th of September 2012) with 100% interest held;
- Elektrum Lietuva UAB (since 7 January 2008) with 100% interest held;
- Latvijas elektriskie tīkli AS (since 10 February 2011) with 100% interest held;
- Enerģijas publiskais tirgotājs AS (since 25 February 2014) with 100% interest held;
- Liepājas enerģija SIA (since 6 July 2005) with 51% interest held.

Latvenergo AS is also shareholder with 46.30% interest held in the company Pirmais Slēgtais Pensiju Fonds AS that manages a defined–contribution corporate pension plan in Latvia.

Latvenergo AS shareholding in subsidiaries and other non–current financial investments are disclosed in Note 14 ‘Non–current Financial Investments’.

The Management Board of Latvenergo AS since 16 November 2015 until the date of approving of the Financial Statements for year 2016 was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Guntars Baļčūns and Guntis Stafeckis.

On 16 December 2016 was established the Supervisory Board of Latvenergo AS and it was comprised of the following members: Andris Ozoliņš (Chairman), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis and Martin Sedlacky.

The Supervisory body – Audit Committee since 4 December 2015 until the date of approving of the Financial Statements for year 2016 was comprised of the following members: Torben Pedersen (Chairman), Svens Dinsdorfs and Marita Salgrāve and since 3 March 2017 until the date of approving of the 2016 Annual Report Audit Committee as well Andris Ozoliņš un Andris Liepiņš.

The Financial Statements for year 2016 include the financial information in respect of Latvenergo AS for the annual period starting 1 January 2016 and ending 31 December 2016 and comparative information for year 2015. Financial Statements for year 2016 are prepared by comparability of financial results, and where it is necessary (see ‘Reclassification of positions’ in Note 2), comparatives for year 2015 are reclassified using the same principles applied for preparation of the 2016 Financial Statements.

The Management Board of Latvenergo AS has approved 2016 Annual report, including the Financial Statements on 18 April 2017. The Company’s Financial Statements are subject to Shareholder’s approval after the issue.

The Company’s auditor is the certified audit company Ernst & Young Baltic SIA (licence No. 17) and certified auditor in charge is Diāna Krišjāne (Latvian certified auditor with certificate No. 124).

## 2. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these Company’s Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where it is necessary comparatives are reclassified.

***Reclassification of positions***

In the Financials Statements of the reporting year 2016 is made reclassification in the Statement of Profit or Loss for transmission services costs in 2015 – costs of transmission services for commercial use in amount of EUR 1,045 thousand is reclassified from ‘Other operating expenses’ to ‘Raw materials and consumables used’.

## 2.1. Basis of preparation

The Company's Financial Statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union. Due to the European Union's endorsement procedure, the standards and interpretations not approved for use in the European Union are also presented in this note as they may have impact on the Company's Financial Statements in the following periods if endorsed.

The Company's Financial Statements are prepared under the historical cost convention, except for some financial assets and liabilities (including derivative financial instruments) measured at fair value through profit or loss and for the revaluation of property, plant and equipment carried at revalued amounts through comprehensive income as disclosed in accounting policies presented below.

The Company's Financial Statements are presented in thousands of euros (EUR).

These are separate financial statements of the Company. The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union and approved by the Management Board of Latvenergo AS on 18 April 2017.

The preparation of the Company's Financial Statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the Company's Management's best knowledge of current events and actions, actual results ultimately may differ from those. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Company's Financial Statements are disclosed in Note 4.

## 2.2. Summary of significant accounting policies

### *2.2.1. Statement of compliance*

The separate financial statements represent the first annual financial statements of the Company prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB) and as adopted by European Union. The Company adopted IFRS in accordance with IFRS 1, First–time adoption of International Financial Reporting Standards. The date of transition to IFRS is 1 January 2015 (see Note 2.3.).

In accordance with IFRS, the Company has:
- Applied the same accounting policies throughout all periods presented;
- Retrospectively applied all effective IFRS standards as of 31 December 2016, as required; and
- Has not applied any of certain optional exemptions and certain mandatory exceptions as applicable for the first–time IFRS adopters (see Note 2.3.).

The Company has adopted all relevant new and/or amended International Financial Reporting Standards or interpretations that are published or revised, which became effective for annual periods beginning on or after 1 January 2016.

### *2.2.2. New or revised standards and interpretations not yet adopted by the Company*

***Amendments to existing standards that are not yet effective but are relevant for the Company's operations***

The Company has not applied the following amendments to IAS, IFRS and its amendments that have been issued as of the date of authorisation of these financial statements for issue, but which will become effective for the reporting periods started from 1 January 2017 or later. At present the Management of the Company evaluates the impact or expected effect from adoption of these standards, but does not consider that these amendments will have significant effect to the Company's Financial Statements, except IFRS 9 "Financial Instruments", IFRS 15 "Revenue from Contracts with Customers" and IFRS 16 "Leases".

- IFRS 9 *Financial Instruments* (effective for financial years beginning on or after 1 January 2018). IFRS 9 replaces IAS 39 and introduces new requirements for classification and measurement, impairment and hedge accounting. The Company will adopt IFRS 9 for the financial year beginning as of 1 January 2018 and is currently assessing the impacts of its adoption on the Company's Financial Statements. Based on preliminary assessment made by the Management, implementation of the standard is expect to have limited or no impact because the Company has only the type of financial instruments for which classification and measurement is not expected to change, mainly trade receivables and payables, derivatives and bank loans taken. Considering that historically there have been very rare cases of impairments of receivables transferring from incurred credit loss model to expected credit loss model is considered to have limited or no impact to the Company's Financial Statements. More detailed assessment will be made in 2017.

- IFRS 15 *Revenue from Contracts with Customers* (effective for financial years beginning on or after 1 January 2018). IFRS 15 establishes a five–step model that will apply to revenue earned from a contract with a customer, regardless of the type of revenue transaction or the industry. Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates. The Company plans to adopt the standard for the financial year beginning as of 1 January 2018 retrospectively, i.e. the comparable period will be presented in accordance with IFRS 15. Currently, it is expected that implementation of standard will change the total amount of revenue to be recognized for a customer contracts, as well as timing of revenue recognition. Based on the preliminary analyses, the Company does not expect significant impacts on its Financial Statements as the Company does not have many long–term contracts with multi–element arrangements. The Company's Management will make the detailed analysis on implementation of the standard in 2017.

- IFRS 15: *Revenue from Contracts with Customers (Clarifications)* (effective for annual periods beginning on or after 1 January 2018, once endorsed by the EU). The objective of the Clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 *Revenue from Contracts with Customers*, particularly the accounting of identifying performance obligations amending the wording of the "separately identifiable" principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The Clarifications also provide additional practical expedients for entities that either applies IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. The Company's Management currently assesses the impact of the Clarifications on the Company's Financial Statements.

- IFRS 16 *Leases* (effective for financial years beginning on or after 1 January 2019, once endorsed by the EU). IFRS 16 replaces IAS 17 and specifies how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessor accounting is substantially unchanged. The Company will adopt IFRS 16 for the financial year beginning as of 1 January 2019, once adopted by the EU, and is currently assessing the impacts of its adoption on the Company's Financial Statements. Upon implementation of IFRS 16, among other considerations, the Company will make an assessment on the identified lease assets, non–cancellable lease terms (including the extension and termination options) and lease payments (including fixed and variable payments, termination option penalties etc.). Detailed analysis on implementation of IFRS 16 will be made in 2017 and 2018.

- Amendments to IAS 7 *Statement of Cash Flows: Disclosure Initiative* (effective for financial years beginning on or after 1 January 2017, once endorsed by the EU). The Amendments improve information provided to users of financial statements about an entity's financing activities. Entities are required to disclose changes in liabilities arising from financing activities, including both changes arising from cash flows and non–cash changes, for example, by providing reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. The implementation of the Amendments will not have any impact on the financial position or performance of the Company but may result in changes in disclosures.

- Amendments to IAS 12 *Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses* (effective for financial years beginning on or after 1 January 2017, once endorsed by the EU). The amendments clarify how to account for deferred tax assets for unrealized losses on debt instruments measured at fair value. The Company has not yet evaluated the impact of the implementation of the Amendments, but considers that they will not have a significant effect on the Company's Financial Statements.

- Amendments to IAS 40: *Transfers to Investment Property* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The Amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The Amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The Company has not yet evaluated the impact of the implementation of the Amendments, but does not consider that any of them will have a significant effect to the Company's Financial Statements.

- IFRIC *Interpretation 22: Foreign Currency Transactions and Advance Consideration* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The

Interpretation clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when an entity recognizes a non–monetary asset or a non–monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non–monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The Company's Management has not yet evaluated the impact of the implementation of the IFRIC Interpretation, but does not consider that it will have a significant effect to the Company's Financial Statements.

The Management of the Company plans to adopt the above mentioned standards and amendments that were applicable for the Company on their effectiveness date.

***Standards issued but not yet effective and not applicable for the Company***

- Amendments to IFRS 10 and IAS 28 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (In December 2015 the IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting). The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business and partial gain or loss is recognised when a transaction involves assets that do not constitute a business. The Company evaluated that these Amendments are not relevant to the Company's operations.
- IFRS 2: *Classification and Measurement of Share based Payment Transactions (Amendments)* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The Amendments provide requirements on the accounting for the effects of vesting and non–vesting conditions on the measurement of cash–settled share–based payments, for share–based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share–based payment that changes the classification of the transaction from cash–settled to equity–settled.

The Management of the Company will not adopt these amendments because they will not be applicable for the Company.

**Improvements to IFRSs**

The IASB has issued the Annual Improvements to IFRSs 2014 – 2016 Cycle, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2017 for IFRS 12 Disclosure of Interests in Other Entities and on or after 1 January 2018 for IFRS 1 First–time Adoption of International Financial Reporting Standards and for IAS 28 Investments in Associates and Joint Ventures. Earlier application is permitted for IAS 28 Investments in Associates and Joint Ventures. These annual improvements have not yet been endorsed by the EU.

- *IFRS 1 First-time Adoption of International Financial Reporting Standards:* This improvement deletes the short–term exemptions regarding disclosures about financial instruments, employee benefits and investment entities, applicable for first–time adopters.
- IAS 28 *Investments in Associates and Joint Ventures:* The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment–by–investment basis, upon initial recognition.
- IFRS 12 *Disclosure of Interests in Other Entities:* The amendments clarify that the disclosure requirements in IFRS 12, other than those of summarized financial information for subsidiaries, joint ventures and associates, apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale, as held for distribution, or as discontinued operations in accordance with IFRS 5.

The adoption of these amendments may result in changes to accounting policies or disclosures but will not have any impact on the financial position or performance of the Company.

### *2.2.3. Financial investments*

#### *a) Investments in subsidiaries*

Investments in subsidiaries are accounted at acquisition cost net of accumulated impairment loss. The cost of an acquisition is measured, as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Costs of investments in subsidiaries in the separate Company's financial statements includes any transaction costs incurred are capitalised even if such costs are expensed in the Group's consolidated financial statements. Identifiable assets acquired and liabilities and contingent liabilities assumed in business combination are measured initially at their fair values at the acquisition date.

When there is objective evidence that the carrying amount of the investment in subsidiary has impaired, the impairment loss is calculated as a difference between the carrying amount of the investment and its recoverable amount. The recoverable amount is determined as the higher of its fair value less costs to sell and its value in use. An impairment loss recognised in prior periods can be reversed only if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

***b) Other financial investments***

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Currently the Company has not investments in associates.

All other financial investments are initially measured at cost, and after initial recognition measured at cost less any accumulated impairment losses.

### 2.2.4. Disclosures of reportable segments

For segment reporting purposes the Company allocates division into reportable segments based on the Company's internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the chief operating decision maker.

The Company allocates its operations into two main reportable segments – Generation and Sales that covers electricity and thermal energy generation and sales, and Corporate Functions that covers administration and other support services, which are presented separately.

### 2.2.5. Foreign currency translation

***a) Functional and presentation currency***

Items included in these Financial Statements are measured using the currency of the primary economic environment in which the Company operates ("the functional currency"). The Company's Financial Statements have been prepared in euros (EUR), which is the Company's functional currency. All figures, unless stated otherwise are rounded to the nearest thousand.

***b) Transactions and balances***

All transactions denominated in foreign currencies are translated into the functional currency according to the European Central bank (ECB) exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency using the exchange rate of the European Central bank at the last day of the reporting year. The resulting gain or loss is charged to the Company's Statement of Profit or Loss.

### 2.2.6. Intangible assets

Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the Company's Statement of Profit or Loss when the asset is derecognised.

***a) Connection usage rights***

Connection usage rights are measured at cost, based on methodology determined by the Public Utilities Commission, net of accumulated amortisation and accumulated impairment losses. Amortisation is calculated using the straight–line method to allocate the cost of connection usage rights to the residual value over the estimated period of relationship with a customer (connection user) – 20 years.

***b) Licenses, software and other usage rights***

Licenses, software and other usage rights, which meet an asset recognition criteria, are measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of licenses and software over their estimated useful lives (5 years). Computer software development costs recognised as assets are amortised over their estimated useful lives, not exceeding a period of five years.

***c) Greenhouse gas emission allowances***

Emission rights for greenhouse gases (or allowances) are initially recognised at purchase cost. Allowances received from the State free of charge are recognised at zero cost as off–balance sheet assets. Emission rights are recognised at cost when the Company is able to exercise the control. If the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, the Company purchases additional allowances and carrying value of those allowances is determined on the basis of the market price of greenhouse gas emission allowances at the reporting period. Allowances are accounted for within 'Intangible assets' (see Note 12 a, b).

### *2.2.7. Property, plant and equipment*

Property, plant and equipment (PPE) are stated at historical cost or revalued amount (see point 2.2.9.), less accumulated depreciation and accumulated impairment losses, if any.

Cost of property, plant and equipment comprises the purchase price, transportation costs, installation, and other direct expenses related to the acquisition or implementation. The cost of the self–constructed item of PPE includes the cost of materials, services and workforce. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of an item can be measured reliably. All other repair and maintenance expenses are charged directly to the Company's Statement of Profit or Loss when the expenditure is incurred. Borrowing costs are capitalised proportionally to the part of the cost of fixed assets under construction over the period of construction. Effective part of the changes in the fair value of forward foreign currencies exchange contracts, the purpose of which is to hedge currency exchange risk on PPE items, is also capitalised and included in the Company's Statement of Profit or Loss along with the expenses of depreciation over the useful life of the asset or at the disposal of the asset.

If an item of PPE consists of components with different useful lives and the cost of these components are significant against the cost of an PPE item, these components are recognised separately.

Land is not depreciated. Depreciation on the other assets is calculated using the straight–line method to allocate their cost over their estimated useful lives, as follows:

| Type of property, plant and equipment (PPE) | Estimated useful life, years |
|---|---|
| **Buildings and facilities, including** | |
| - hydropower plants and combined heat and power plants | 15 – 100 |
| - other buildings and constructions | 20 – 80 |
| **Technology equipment and machinery (TEM), including** | |
| - hydropower plants | 10 – 40 |
| - combined heat and power plants | 3 – 25 |
| - other technology equipment and machinery | 10 – 20 |
| **Other property, plant and equipment** | 2 – 25 |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see point 2.2.10.).

Gains or losses on property, plant and equipment disposals are determined by comparing proceeds with carrying amounts. Those are included in the Company's Statement of Profit or Loss. If revalued property, plant and equipment have been sold or disposed, appropriate amounts are reclassified from revaluation reserve to retained earnings.

All fixed assets under construction are stated at historical cost and comprised costs of construction of assets. The initial cost includes construction and installation costs and other direct costs related to construction of fixed assets. Assets under construction are not depreciated as long as the relevant assets are completed and ready for intended use, but are tested for impairment annually, either individually or at the cash-generating unit level. The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

### *2.2.8. Investment properties*

Investment properties are land or a building or part of a building held by the Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business. The investment properties are initially recognised at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses, if any. The applied depreciation rates are based on estimated useful life set for respective fixed asset categories – from 15 to 80 years. Investment properties does not meet the criteria to be classified as held for sale, or included within a disposal group classified as held for sale in accordance with IFRS 5 – *Non–current assets Held for Sale and Discontinued Operations* as sales of such assets are not highly probable.

### *2.2.9. Revaluation of property, plant and equipment*

Revaluations have been made with sufficient regularity to ensure that the carrying amount of property, plant and equipment items subject to valuation does not differ materially from that which would be determined using fair value at the end of reporting period.

Daugava hydropower plants property, plant and equipment categories grouped by following groups are revalued regularly but not less frequently than every five years:

- buildings and facilities of Daugava hydropower plants,
- technology equipment and machinery of Daugava hydropower plants,
- other equipment of Daugava hydropower plants.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the 'Other comprehensive income' as "Property, plant and equipment revaluation reserve" in the Shareholder's equity. Decreases that offset previous increases of the same asset are charged in 'Other comprehensive income' and debited against the revaluation reserve directly in equity; all other decreases are charged to the Company's current year's Statement of Profit or Loss. Any gross carrying amounts and accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

Property, plant and equipment revaluation reserve is decreased at the moment, when revalued asset has been eliminated or disposed.

Revaluation reserve cannot be distributed in dividends, used for indemnity, reinvested in other reserves, or used for other purposes.

### *2.2.10. Impairment of assets*

Assets that are subject to depreciation or amortisation and land are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher amount of the asset's fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre–tax discount rate that reflects the current market expectations regarding the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash–generating unit to which the asset belongs. Impairment losses are recognised in the 'Other comprehensive income' within PPE revaluation reserve for the assets accounted at revalued amount and in the Company's Statement of Profit or Loss within amortisation, depreciation and impairment charge expenses for the assets that are accounted at cost, less depreciation and impairment, and for the assets accounted at revalued amount in case if impairment charge exceeds revaluation surplus previously recognised on individual asset.

The key assumptions used in determining recoverable amount of the asset are based on the Company's management best estimation of the range of economic conditions that will exist over the remaining useful life of the asset, on the basis of the most recent financial budgets and forecasts approved by the Company's management for a maximum period of 10 years. Assets are reviewed for possible reversal of the impairment whenever events or changes in circumstances indicate that impairment must be reviewed. The reversal of impairment for the assets that are accounted at cost, less depreciation and impairment, is recognised in the Company's Statement of Profit or Loss. Reversal of impairment loss for revalued assets is recognised in the Company's Statement of Profit or Loss to the extent that an impairment loss on the same revalued asset was previously recognised in the Company's Statement of Profit or Loss; the remaining reversals of impairment losses of revalued assets are recognised in 'Other comprehensive income'.

### *2.2.11. Leases*

#### *a) The Company is the lessee*
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the Company's Statement of Profit or Loss on a straight–line basis over the period of the lease (see Note 13 e).

#### *b) The Company is the lessor*
Assets leased out under operating leases are recorded within investment property at historic cost less depreciation and accumulated impairment loss, if any. Depreciation is calculated on a straight–line basis to write down each asset to its estimated residual value over estimated useful life. Rental income from operating lease and advance payments received from clients (less any incentives given to lessee) are

recognised in the Company's Statement of Profit or Loss on a straight–line basis over the period of the lease (see Note 13 e).

### *2.2.12. Inventories*

Inventories are stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost is determined using the weighted average method.

Purchase cost of inventories consists of the purchase price, import charges and other fees and charges, freight–in and related costs as well as other costs directly incurred in bringing the materials and goods to their present location and condition. The value of inventories is assigned by charging trade discounts, reductions and similar allowances.

Existance of inventories as of the end of reporting period is verified during stock–taking.

At the end of each reporting year the inventories are reviewed for any indications of obsolescence. In cases when obsolete or damaged inventories are identified allowances are recognised. During the reporting year at least each month stock–count of the inventories is performed with the purpose to identify obsolete and damaged inventories. Allowances for an impairment loss are recognised for those inventories.

The following basic principles are used in determining impairment losses for idle and obsolete inventories:

a) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and combined heat and power plants that haven't turned over during last 12 months are impaired in amount of 90%,
b) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and combined heat and power plants that haven't turned over during last 6 months are impaired in amount of 45%,
c) Other inventories that haven't turned over during last 6 months are impaired in amount of 50%,
d) Allowances are not calculated for the inventory of hydropower plants and heating materials necessary to ensure uninterrupted operations of hydropower and combined heat and power plants, for natural gas and scraps,
e) All other inventories not mentioned above and that have not turned over during last 12 months are fully impaired.

### *2.2.13. Trade and other receivables*

Trade receivables are recognised initially at fair value and subsequently carried at amortised cost. An allowance for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of repayment. Significant financial difficulties of the debtor, probabilities that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered as indicators that the trade receivable is impaired.

Trade receivables are classified in groups:

a) Electricity supply and electricity services receivables,
b) Heating receivables,
c) Other services trade receivables (IT & telecommunication services, assets' lease and maintenance, management, vehicle fleet management, customer service, credit control and other services).

An allowance for impairment of doubtful debts is calculated on the basis of trade receivables aging analysis according to estimates defined by the Company's management, which are revised at least once a year. Allowances for electricity supply and electricity services receivables are calculated for debts overdue 45 days, and, if the debt is overdue for more than 181 day, allowances are established at 100%. For heating and other services trade receivables allowances are calculated for debts overdue 31 day, and, if the date of payment is overdue for more than 91 day, allowances are established at 100% (see Note 16 a).

Individual impairment assessments are performed for the debtors:

a) If their debt balance exceeds EUR 700 thousand or they have a financial difficulties and debt repayment schedule has been individually agreed, allowances are calculated individually,
b) If debtor has been announced as insolvent, allowances are established at 100%.

The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Company's Statement of Profit or Loss within 'Other operating expenses' as selling expenses and customer service costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against selling and customer services costs in the Company's Statement of Profit or Loss.

### *2.2.14. Cash and cash equivalents*

Cash and cash equivalents include cash balances on bank accounts, demand deposits at bank and other short–term deposits with original maturities of three months or less. Cash and cash equivalents also are consisting of restricted cash, that are excluded from cash and cash equivalents in the Statement of Cash Flows.

### *2.2.15. Dividend distribution*

Dividend distribution to the Shareholder of the Company is recognised as a liability in the Company's Financial Statements in the period in which the dividends are approved by the Company's Shareholder.

### *2.2.16. Pensions and employment benefits*

#### *a) Pension obligations*

The Company makes monthly contributions to a closed defined contribution pension plan on behalf of its employees. The plan is managed by the non–profit public limited company Pirmais Slēgtais Pensiju Fonds, with the participation of Latvenergo AS amounting for 46.30% of its share capital. A defined contribution plan is a pension plan under which the Company pays contributions into the plan. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods. The contributions amount to 5% of each pension plan member's salary. The Company recognises the contributions to the defined contribution plan as an expense when an employee has rendered services in exchange for those contributions.

#### *b) Provisions for post-employment obligations arising from collective agreement*

In addition to the aforementioned plan, the Company provides certain post–employment benefits to employees whose employment meets certain criteria. Obligations for benefits are calculated taking into account the current level of salary and number of employees eligible to receive the payment, historical termination rates as well as number of actuarial assumptions.

The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

The liability is recognised in the Company's Statement of Financial Position in respect of post–employment benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds. The Company uses projected unit credit method to establish its present value of fixed benefit obligation and related present and previous employment expenses. According to this method it has been stated that each period of work makes benefit obligation extra unit and the sum of those units comprises total Company's obligations of post–employment benefits. The Company uses objective and mutually compatible actuarial assumptions on variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

Actuarial gains or losses arising from experience adjustments and changes in actuarial assumptions net of deferred income tax are charged or credited to the Company's Statement of Other Comprehensive Income in the period in which they arise. Past service costs are recognised immediately in the Statement of Profit or Loss.

### *2.2.17. Income tax*

#### *a) Corporate income tax*

Income tax expense for the period comprises current income tax and deferred income tax. Current income tax charges are calculated on current profit before tax using the tax rate 15% in accordance with applicable tax regulations of the Republic of Latvia as adjusted for certain non–deductible expenses/non–taxable income and are based on the taxable income reported for the taxation period.

#### *b) Deferred income tax*

Deferred income tax is provided in full, using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity. However, the deferred income tax is not accounted if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax is determined using tax rates (and laws) that have been enacted by the end of reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit of the Company will be available against which the temporary differences can be utilised.

Tax incentives for new technological equipment are not considered when calculating deferred income tax.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

### *2.2.18. Subsidised Energy Tax*

In order to limit the increase of the mandatory procurement public service obligation (PSO) fee for electricity consumers in Latvia, a Subsidised Energy Tax (SET) has been introduced for a four–year period as of 1 January 2014, which applies to state support for generators of subsidised electricity. The SET applies both to income from electricity supplied under the mandatory procurement process as well as to mandatory procurement capacity payments for installed capacity at cogeneration plants. The tax is differentiated according to the type of energy sources used. For cogeneration plants that use fossil energy sources a 15% tax rate applies to the received support (taxable income) amount, 10% tax rate – for plants that use renewable energy sources, 5% – for cogeneration plants that use gas, biogas and biomass energy sources and installed electrical capacity in cogeneration plants is below 4 MW. Payers of SET are all producers of subsidised electricity. Revenues from SET are used as a funding for the grant included in the State Budget programme “Electricity user support” to limit the increase of mandatory procurement PSO fee. SET applied for the subsidised electricity produced by the Company is recognised in the Statement of Profit or Loss as ‘Other operating expenses’ (Note 9) at gross amount.

### *2.2.19. Borrowing costs*

General and specific borrowing costs directly attributable to the acquisition or construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that the Company incurs in connection with the borrowing of funds.

### *2.2.20. Provisions*

Provisions are recognised when the Company has a present obligation as a result of past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and when a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

Provisions are presented in the Company’s Statement of Financial Position at the best estimate of the expenditure required to settle the present obligation at the end of reporting period. Provisions are used only for expenditures for which the provisions were originally recognised and are reversed if an outflow of resources is no longer probable.

Provisions are measured at the present value of the expenditures expected to be required for settling the obligation by using pre–tax rate that reflects current market assessments of the time value of the money and the risks specific to the obligation as a discount rate. The increase in provisions due to passage of time is recognised as interest expense.

Environmental protection provisions are recognised to cover environmental damages that have occurred before the end of the reporting period when this is required by law or when the Company’s past environmental policies have demonstrated that the Company has a constructive present obligation to liquidate this environmental damage. Experts’ opinions and prior experience in performing environmental work are used to set up the provisions (see Note 21 b).

### *2.2.21. Grants*

Government grants are recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis. A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Property, plant and equipment received at nil consideration are accounted for as grants. Those grants are recognised at fair value as deferred income and are credited to the Company’s Statement of Profit or Loss on a straight–line basis over the expected lives of the related assets.

***Financing provided by European Union funds***

The Company ensures the management, application of internal controls and accounting for the Company's projects financed by the European Union funds, according to the guidelines of the European Union and legislation of the Republic of Latvia.

Accounting of the transactions related to the projects financed by the European Union is ensured using separately identifiable accounts. The Company ensures separate accounting of financed projects with detailed income and expense, non–current investments and value added tax in the relevant positions of the Company's Statement of Profit or Loss and Statement of Financial Position.

### *2.2.22. Financial instruments – initial recognition, subsequent measurement and de–recognition*

### *a) Financial assets*

*I) Initial recognition and measurement*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held–to–maturity investments, available–for–sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Company commits to purchase or sell the asset.

*II) Subsequent measurement*

**Financial assets at fair value through profit or loss**

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non–current. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the Company's Statement of Profit or Loss. Financial assets designated upon initial recognition at fair value through profit or loss are designated at their initial recognition date and only if the criteria under IAS 39 are satisfied. The Company has not designated any financial assets at fair value through profit or loss.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value though profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss.

**Loans and receivables**

Loans and receivables are non–derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate (hereinafter – EIR) method, less impairment. The losses arising from impairment are recognised in the Company's Statement of Profit or Loss in finance costs for loans and in other operating expenses for receivables.
Company's issued loans are recognised initially at fair value and subsequently measured at amortised cost, less impairment. The amount between loans issued and loans repayment value is gradually recognised in the Company's Statement of Profit or Loss during the period of the loan maturity. Loans are classified as current receivables and non–current receivables.

**Held–to–maturity investments**

Non–derivative financial assets with fixed or determinable payments and fixed maturities are classified as held to maturity when the Company has the positive intention and ability to hold them to maturity. After initial measurement, held to maturity investments are measured at amortised cost using the EIR, less impairment. If the Company were to sell other than an insignificant amount of held–to–maturity financial assets, the whole category would be tainted and reclassified as available for sale. Held–to–maturity financial assets with maturities more than 12 months from the end of the reporting period are included in non–current assets; however those with maturities less than 12 months from the end of the reporting period are classified as current assets.

The Company follows the *IAS 39* guidance on classifying non–derivative financial assets with fixed or determinable payments and fixed maturity as held–to–maturity. This classification requires significant judgement. In making this judgement, the Company evaluates its intention and ability to hold such investments to maturity (see Note 4 d).

If the Company fails to keep these investments to maturity other than for specific circumstances explained in *IAS 39*, it will be required to reclassify the whole class as available–for–sale. Therefore the investments would be measured at fair value not at amortised cost.

Purchases and sales of financial assets held–to–maturity are recognised on trade date – the date on which the Company commits purchase of the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired. Held–to–maturity financial assets are carried at amortised cost using the effective interest rate method, net of accumulated impairment losses. Gains and losses arising from changes in the amortised value of the financial instruments are included in the Company's Statement of Profit or Loss in the period in which they arise.

**Available–for–sale financial assets**
Available–for–sale financial assets include equity instruments and debt securities. After initial measurement available–for–sale financial assets are subsequently measured at fair value with unrealised gains or losses recognised in other comprehensive income and credited in the available–for–sale financial assets reserve until the investment is derecognised. The Company does not have such assets.

*III) De–recognition*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

1) the rights to receive cash flows from the asset have expired,
2) the Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either (a) the Company has transferred substantially all the risks and rewards of the asset, or (b) the Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

### *b) Financial liabilities*

*I) Initial recognition and measurement*

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

The Company's financial liabilities include trade and other payables, bank overdrafts, loans and borrowings, financial guarantee contracts, and derivative financial instruments.

*II) Subsequent measurement*

**Financial liabilities at fair value through profit or loss**
Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. This category includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the Company's Statement of Profit or Loss.

**Loans and borrowings**
Loans and borrowings are recognised initially at fair value. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the Company's Statement of Profit or Loss, except for the capitalised part. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability at least for 12 months after the end of reporting period.

**Trade and other payables**
The Company's trade payables are recognised initially at fair value and subsequently measured at amortised cost using the EIR method.

*III) De–recognition*
A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de–recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the Company's Statement of Profit or Loss.

### *2.2.23. Derivative financial instruments and hedging activities*

The Company uses derivatives such as interest rate swaps and electricity forward and future contracts to hedge risks associated with the interest rate and purchase price fluctuations.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re–measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate (see point 2.2.24.).

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, on the nature / content of the relevant asset or liability being hedged.

The Company designates certain derivatives as hedges of a particular risk associated with specific variable rate borrowings (cash flow hedge). Other derivatives are accounted for at fair value through profit or loss.

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Company also documents its assessment, both at hedge inception and on an on–going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of the derivative instruments is presented as current or non–current based on settlement date. Derivative instruments that have maturity of more than twelve months and have been expected to be hold for more than twelve months after the end of the reporting year are classified as non–current assets or liabilities. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

#### *a) Cash flow hedge*
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in 'Other comprehensive income' and accumulated in the Company's equity within 'Hedging reserve'. The gain or loss relating to the ineffective portion, if such arise, would be recognised immediately in the Company's Statement of Profit or Loss.

Amounts accumulated in equity are recycled in the Company's Statement of Profit or Loss in the periods when the hedged item affects profit or loss.

The gain or loss relating to the ineffective portion of interest rate swaps hedging variable rate borrowings is recognised in the Company's Statement of Profit or Loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the Company's Statement of Profit or Loss.

#### *b) Fair value changes of derivatives through profit and loss*
Changes in the fair value of derivatives at fair value through profit or loss, ineffective part of changes in the fair value of hedging derivatives and amounts accumulated in equity that are recycled to the Company's Statement of Profit or Loss, are classified according to the purpose of the derivatives – gains/losses from electricity forward and future contracts are recognised within 'Raw materials and consumables used', while gains / losses from interest rate swap agreements and forward foreign currencies exchange contracts are recognised within 'Finance costs' or 'Finance income'.

### *2.2.24. Fair value measurement*

The Company measures financial instruments, such as, derivatives, at fair value at each balance sheet date. Such non–financial assets as investment properties are measured at amortised cost, but some items of property, plant and equipment at revalued amounts. Also fair values of financial instruments and investment properties held for capital appreciation measured at amortised cost are disclosed in Note 20 d.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values are estimated based on market prices and discounted cash flow models as appropriate (see Note 4 f).

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of reporting period. The quoted market prices used for financial assets held by the Company is the current bid prices.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company use a variety of methods and make assumptions that are based on market conditions existing at each end of reporting period. Estimated discounted cash flows are used to determine fair value for the remaining financial instruments.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments.
The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices multiplied by the volume of the agreement.

If counterparty is a bank, then fair values of financial instruments are obtained from corresponding bank's revaluation reports and in financial statements fair values of financial instruments as specified by banks are disclosed. In case of electricity forward and future contracts concluded with counterparties others than a bank; fair values as calculated by the Company are disclosed in Financial Statements.

### *2.2.25. Revenue recognition*

Revenue comprises the value of goods sold and services rendered in the ordinary course of the Company's business activities. Revenue is measured at the fair value of the consideration received or receivable, net of value–added tax, estimated returns, rebates and discounts. The Latvian regulatory authority (Public Utilities Commission) determines tariffs for heat.

Revenue is recognised as follows:

***a) Electricity sales***

The Company records electricity sales to residential customers on the basis of reported meter readings. Where relevant, this includes an estimate of the electricity supplied between the date of the last meter reading and the year–end. Electricity sales to corporate and private customers are recognised on the basis of issued invoices according to meter readings of customers considering contractual prices included in electricity trade agreements. Revenues from trade of electricity in *Nord Pool AS* power exchange are based on the calculated market prices.

***b) Heat sales***

The Company recognises revenue from sales of thermal energy at the end of each month on the basis of the meter readings.

***c) Sales of IT & telecommunication services***

Revenues derived from information technology services (internet connection services, data communication services), open electronic communication network and telecommunication services to customers are recognised on the basis of invoices which are prepared for clients upon usage of services listed in telecommunications billing system.

***d) Other revenue***

Revenue derived from assets lease and maintenance, management, vehicle fleet management, customer service, credit control and other services are recognised according to services rendered to customers in accordance to mutual agreements.

***e) Interest income***

Interest income is recognised using the effective interest method. Interest income is recorded in the Company's Statement of Profit or Loss as 'Finance income'.

#### f) Dividend income
Revenue is recognised when the Company's right to receive the payment is established, which is generally when shareholders approve the dividend (Notes 14 a). Received dividends are recorded in the Company's Statement of Profit or Loss as 'Received dividends from subsidiaries'.

#### g) Income on mandatory procurement public service obligation fee
Revenue from mandatory procurement public service obligation fee is recognised based on regulated tariffs that are subject to approval by the Public Utilities Commission in the Company's Statement of Profit or Loss in net amount by applying the agent accounting principle as:
- The entity does not have the primary responsibility for including the mandatory procurement PSO fee per invoices issued to the customers;
- The entity has no latitude in establishing prices, either directly or indirectly.

#### h) Electricity transmission and distribution services
Revenue from electricity transmission and distribution system services is recognised based on regulated tariffs that are subject to approval by the Public Utilities Commission. Electricity transmission and distribution services are recognised in the Company's Statement of Profit or Loss in net amount by applying the agent accounting principle as:
- The entity does not have the primary responsibility for including electricity transmission and distribution services per invoices issued to the customers,
- The entity has no latitude in establishing prices, either directly or indirectly.

### 2.2.26. Related parties

The parties are considered related when one party has a possibility to control the other one or has significant influence over the other party in making financial and operating decisions. Related parties of the Company are Shareholder of the Company who could control or who has significant influence over the Company in accepting operating business decisions, members of Management board and Supervisory board of the Company, members of Supervisory body – Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence. As the shares of Latvenergo AS belong 100% to the Republic of Latvia, the related parties also include entities under the control or significant influence of the state (Note 23).

### 2.2.27. Non–current assets held for sale

The Company classifies non–current assets as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, and sale is considered highly probable. Non–current assets held for sale are measured at the lower of their carrying amount and fair value less costs of selling.

### 2.2.28. Share capital

The Company's share capital consists of ordinary shares. All shares have been fully paid.

### 2.2.29. Events after the reporting period

Events after the reporting period that provide additional information about the Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Events after the reporting period that are not adjusting events are disclosed in the notes when material.

## 2.3. First–time adoption of IFRS

These Financial Statements, for the year ended 31 December 2016, are the first the Company has prepared in accordance with IFRS. For periods up to and including the year ended 31 December 2015, the Company prepared its Financial Statements in accordance with local generally accepted accounting principles as defined by the "Annual Accounts Law of the Republic of Latvia" (Local GAAP).

Accordingly, the Company has prepared its Financial Statements that comply with IFRS applicable as at 31 December 2016, together with the comparative period data for the year ended 31 December 2015, as described in the summary of significant accounting policies. In preparing the Financial Statements, the Company's opening Statement of Financial Position was prepared as of 1 January 2015, the Company's date of transition to IFRS.

This note explains the principal adjustments ('Remeasurements') made by the Company in restating its Local GAAP Financial Statements in accordance with IFRS, including the Statement of Financial Position as of 1 January 2015 and the Financial Statements for the year ended 31 December 2015. All other position transitions which have no material impact on financial results are disclosed as 'Positions reclassified'.

***Exemptions applied***

IFRS 1 allows first–time adopters certain exemptions from the retrospective application of certain requirements under IFRS, but the Company has not applied any of these exemptions.

***Estimates***

The estimates at 1 January 2015 and at 31 December 2015 are consistent with those made for the same dates in accordance with Local GAAP (after adjustments to reflect any differences in accounting policies).

## Reconciliation of the Company's equity as of 1 January 2015 (date of transition to IFRS)

| | Local GAAP 01/01/2015 | Remea–surements | Positions reclassified | IFRS 01/01/2015 |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **ASSETS** | | | | |
| **Non–current assets** | | | | |
| Intangible assets | 18,687 | – | – | 18,687 |
| Property, plant and equipment | – | – | 1,360,664 | 1,360,664 |
| Land and buildings | 876,738 | – | (876,738) | – |
| Equipment and machinery | 429,276 | – | (429,276) | – |
| Other property, plant and equipment | 34,015 | – | (34,015) | – |
| Assets under construction and advances for property, plant and equipment | 20,634 | – | (20,634) | – |
| Investment properties | 69,253 | – | 1,136 | 70,388 |
| Investment properties held for sale | 1,136 | – | (1,136) | – |
| Non–current financial investments | – | – | 817,049 | 817,049 |
| Investments in subsidiaries | 817,009 | – | (817,009) | – |
| Investments in associates and other non-current investments | 40 | – | (40) | – |
| Non–current loans to subsidiaries | 338,834 | – | – | 338,834 |
| Investments in held–to–maturity financial assets | 28,528 | – | – | 28,528 |
| **Total non–current assets** | **2,634,150** | **–** | **–** | **2,634,150** |
| **Current assets** | | | | |
| Inventories | 8,742 | – | – | 8,742 |
| Trade receivables and other receivables | – | – | 133,186 | 133,186 |
| Trade receivables | 70,351 | – | (70,351) | – |
| Receivables from subsidiaries | 40,302 | – | (40,302) | – |
| Corporate income tax overpayment | 4,565 | – | (4,565) | – |
| Other receivables | 16,182 | – | (16,182) | – |
| Current loans to subsidiaries | 241,334 | – | (2,394) | 238,940 |
| Deferred expenses | – | – | 608 | 608 |
| Cash and cash equivalents | 88,966 | – | – | 88,966 |
| **Total current assets** | **470,442** | **–** | **–** | **470,442** |
| **TOTAL ASSETS** | **3,104,592** | **–** | **–** | **3,104,592** |
| **EQUITY** | | | | |
| Share capital | 1,288,446 | – | – | 1,288,446 |
| Reserves | – | – | 645,719 | 645,719 |
| Non–current assets revaluation reserve | 662,052 | – | (662,052) | – |
| Hedge reserve | (16,333) | – | 16,333 | – |
| Other reserves* | 78,524 | (78,524) | – | – |
| Retained earnings* | 34,977 | 78,524 | – | 113,501 |
| **Total equity** | **2,047,666** | **–** | **–** | **2,047,666** |
| **PROVISIONS** | | | | |
| Provisions for post–employment benefits | 4,510 | – | (4,510) | – |
| Environmental provisions | 1,205 | – | (1,205) | – |
| **Total provisions** | **5,715** | **–** | **(5,715)** | **–** |
| **LIABILITIES** | | | | |
| **Non–current liabilities** | | | | |
| Borrowings | – | – | 673,817 | 673,817 |
| Borrowings from credit institutions | 569,015 | – | (569,015) | – |
| Issued debt securities (bonds) | 104,802 | – | (104,802) | – |
| Deferred income tax liabilities | 123,102 | – | – | 123,102 |
| Provisions | – | – | 5,715 | 5,715 |
| Derivative financial instruments | 11,698 | – | – | 11,698 |
| Other liabilities and deferred income | – | – | 749 | 749 |
| Other non–current payables and deferred income | 749 | – | (749) | – |
| **Total non–current liabilities** | **809,366** | **–** | **5,715** | **815,081** |

| | Local GAAP 01/01/2015 | Remea–surements | Positions reclassified | IFRS 01/01/2015 |
|---|---|---|---|---|
| **Current liabilities** | | | | |
| Trade and other payables | – | – | 96,087 | 96,087 |
| Deferred income | – | – | 39 | 39 |
| Trade payables | 31,352 | – | (31,352) | – |
| Accounts payable to subsidiaries | 51,559 | – | (51,559) | – |
| Taxes and the state social security contributions | 5,917 | – | (5,917) | – |
| Other payables | 2,882 | – | (2,882) | – |
| Accrued liabilities | 4,416 | – | (4,416) | – |
| Borrowings | – | – | 136,864 | 136,864 |
| Borrowings from credit institutions | 136,170 | – | (136,170) | – |
| Issued debt securities (bonds) | 694 | – | (694) | – |
| Derivative financial instruments | 8,855 | – | – | 8,855 |
| **Total current liabilities** | **241,845** | **–** | **–** | **241,845** |
| | | | | |
| **TOTAL EQUITY AND LIABILITIES** | **3,104,592** | **–** | **–** | **3,104,592** |

* under the Local GAAP Latvenergo AS transferred retained earnings to the Company's 'Other reserves' with a purpose to sustain future development of the Company in amount of EUR 78,524 thousand, which were accumulated before 1 January 2015, according to IFRS have been recognised at 1 January 2015 as retained earnings that could used according to decision of the Shareholder

## Reconciliation of the Company's equity as of 31 December 2015

| | Local GAAP as of 31/12/2015 | Remea–surements | Positions reclassified | IFRS as of 31/12/2015 |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **ASSETS** | | | | |
| **Non–current assets** | | | | |
| Intangible assets | 19,846 | – | – | 19,846 |
| Property, plant and equipment | – | – | 1,344,670 | 1,344,670 |
| Land and buildings | 859,123 | – | (859,123) | – |
| Equipment and machinery | 384,359 | – | (384,359) | – |
| Other property, plant and equipment | 39,024 | – | (39,024) | – |
| Assets under construction and advances for property, plant and equipment | 62,164 | – | (62,164) | – |
| Investment property | 71,041 | – | 522 | 71,563 |
| Investment properties held for sale | 522 | – | (522) | – |
| Non–current financial investments | – | – | 817,049 | 817,049 |
| Investments in subsidiaries | 817,009 | – | (817,009) | – |
| Investments in associates and other non-current investments | 40 | – | (40) | – |
| Non–current loans to subsidiaries | 362,605 | – | – | 362,605 |
| Other non–current receivables | 1,706 | – | – | 1,706 |
| Investments in held–to–maturity financial assets | 20,609 | – | – | 20,609 |
| **Total non–current assets** | **2,638,048** | **–** | **–** | **2,638,048** |
| | | | | |
| **Current assets** | | | | |
| Inventories | 8,388 | – | – | 8,388 |
| Trade receivables and other receivables | – | – | 103,868 | 103,868 |
| Trade receivables | 76,877 | – | (76,877) | – |
| Receivables from subsidiaries | 23,930 | – | (23,930) | – |
| Other receivables | 3,061 | – | (3,061) | – |
| Current loans to subsidiaries | 261,972 | – | – | 261,972 |
| Deferred expenses | 2,100 | – | – | 2,100 |
| Investments in held–to–maturity financial assets | 7,859 | – | – | 7,859 |
| Cash and cash equivalents | 101,819 | – | – | 101,819 |
| **Total current assets** | **486,006** | **–** | **–** | **486,006** |
| | | | | |
| **TOTAL ASSETS** | **3,124,054** | **–** | **–** | **3,124,054** |
| | | | | |
| **EQUITY** | | | | |
| Share capital | 1,288,531 | – | – | 1,288,531 |
| Reserves | – | – | 649,779 | 649,779 |
| Non–current assets revaluation reserve | 662,035 | – | (662,035) | – |
| Hedge reserve | (12,256) | – | 12,256 | – |
| Other reserves* | 82,022 | (82,022) | – | – |
| Retained earnings* | 94,533 | 82,057 | – | 176,590 |
| **Total equity attributable to equity holder of the Company** | **2,114,865** | **35** | **–** | **2,114,900** |

| | Local GAAP as of 31/12/2015 | Remea–surements | Positions reclassified | IFRS as of 31/12/2015 |
|---|---|---|---|---|
| **PROVISIONS** | | | | |
| Provisions for post–employment benefits | 5,445 | – | (5,445) | – |
| Environmental provisions | 1,160 | – | (1,160) | – |
| **Total provisions** | **6,605** | **–** | **(6,605)** | **–** |
| | | | | |
| **LIABILITIES** | | | | |
| **Non–current liabilities** | | | | |
| Borrowings | – | – | 701,822 | 701,822 |
| Borrowings from credit institutions | 522,117 | – | (522,117) | – |
| Issued debt securities (bonds) | 179,705 | – | (179,705) | – |
| Deferred income tax liabilities | 127,934 | (35) | – | 127,899 |
| Provisions | – | – | 6,605 | 6,605 |
| Derivative financial instruments | 8,291 | – | – | 8,291 |
| Other liabilities and deferred income | – | – | 1,133 | 1,133 |
| Other non–current payables and deferred income | 1,133 | – | (1,133) | – |
| **Total non–current liabilities** | **839,180** | **(35)** | **6,605** | **845,750** |
| | | | | |
| **Current liabilities** | | | | |
| Trade and other payables | – | – | 71,289 | 71,289 |
| Deferred income | – | – | 59 | 59 |
| Income tax payable | – | – | 3,630 | 3,630 |
| Trade payables | 27,582 | – | (27,582) | – |
| Accounts payable to subsidiaries | 33,774 | – | (33,774) | – |
| Taxes and the state social security contributions | 7,946 | – | (7,946) | – |
| Other payables | 1,948 | – | (1,948) | – |
| Accrued liabilities | 3,728 | – | (3,728) | – |
| Borrowings | – | – | 81,143 | 81,143 |
| Borrowings from credit institutions | 79,641 | – | (79,641) | – |
| Issued debt securities (bonds) | 1,502 | – | (1,502) | – |
| Derivative financial instruments | 7,283 | – | – | 7,283 |
| **Total current liabilities** | **163,404** | **–** | **–** | **163,404** |
| | | | | |
| **TOTAL EQUITY AND LIABILITIES** | **3,124,054** | **–** | **–** | **3,124,054** |

* under the Local GAAP Latvenergo AS transferred retained earnings to the Company's 'Other reserves' with a purpose to sustain future development of the Company in amount of EUR 82,022 thousand, which were accumulated before 31 December 2015, according to IFRS have been recognised at 31 December 2015 as retained earnings that could used according to decision of the Shareholder

## Reconciliation of the Company's total comprehensive income for the year ended 31 December 2015

| | Local GAAP for the 31/12/2015 | Remea–surements** | Positions reclassified | IFRS for the 31/12/2015 |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Revenue** | **521,146** | **–** | **–** | **521,146** |
| Other income | 1,716 | (21) | – | 1,695 |
| Raw materials and consumables used | (252,882)* | – | – | (252,882) |
| Personnel expenses | (38,555) | 234 | – | (38,321) |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | (90,507) | – | – | (90,507) |
| Other operating expenses | (49,611)* | – | (1,045) | (50,656) |
| **Operating profit** | **91,307** | **213** | **(1,045)** | **90,475** |
| Income from investments in subsidiaries and associates | 17,739 | – | (17,739) | – |
| Finance income | 14,097 | – | – | 14,097 |
| Finance costs | (19,099) | – | – | (19,099) |
| Received dividends from subsidiaries | – | – | 17,739 | 17,739 |
| **Profit before tax** | **104,044** | **–** | **–** | **103,212** |
| Real estate tax | (1,045) | – | 1,045 | – |
| Income tax | (8,465) | 3 | – | (8,462) |
| **Profit for the year** | **94,534** | **216** | **–** | **94,750** |

* in the Financials Statements of the reporting year 2016 is made reclassification in the Statement of Profit or Loss for transmission services costs in 2015 – costs of transmission services for commercial use in amount of EUR 1,045 thousand reclassified from 'Other operating expenses' to 'Raw materials and consumables used'

** under Local GAAP, the Company recognised costs or income related to re–measurement on defined post–employment benefit plan in profit or loss as 'Personnel expenses' and revenue from disposal of property, plant and equipment revaluation reserve when revalued asset has been eliminated or disposed in profit or loss as 'Other income'

**Other comprehensive income**

| | Local GAAP for the 31/12/2015 | Remea–surements | Positions reclassified | IFRS for the 31/12/2015 |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Profit for the year** | **94,534** | **216** | **–** | **94,750** |
| ***Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):*** | | | | |
| Gains from change in hedge reserve | – | 4,077 | – | 4,077 |
| **Net other comprehensive income to be reclassified to profit or loss in subsequent periods** | **–** | **4,077** | **–** | **4,077** |
| ***Other comprehensive loss not to be reclassified to profit or loss in subsequent periods (net of tax):*** | | | | |
| Loss as a result of re–measurement on defined post–employment benefit plan | – | (199) | – | (199) |
| **Net other comprehensive loss not to be reclassified to profit or loss in subsequent periods** | **–** | **(199)** | **–** | **(199)** |
| **Other comprehensive income for the year, net of tax** | **–** | **3,878** | **–** | **3,878** |
| **Total other comprehensive income for the year** | **–** | **4,094** | **–** | **98,628** |

Under IFRS results of re–measurement on defined post–employment benefit plan is recognised as 'Other comprehensive income' and disposal of property, plant and equipment revaluation reserve as a direct transfer from reserve to retained earnings of the Company.

## Reconciliation of the Company's cash flows for the year ended 31 December 2015

The transition from Local GAAP to IFRS has not had a material impact on the Company's Statement of Cash Flows except remeasurement effect on 'Profit before tax' arised from reclassification of 'Real estate tax' to 'Other operating expenses', effect of re–measurement on defined post–employment benefit plan is recognised as 'Other comprehensive income' and disposal of property, plant and equipment revaluation reserve as a direct transfer from reserve to retained earnings of the Company.

| | Local GAAP for the 31/12/2015 | Remea–surements | Positions reclassified | IFRS for the 31/12/2015 |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Cash flows from operating activities** | | | | |
| Profit before tax | 104,044 | (832) | – | 103,212 |
| **Adjustments :** | | | | |
| – Amortisation, depreciation and impairment of intangible assets and property, plant and equipment | – | – | 90,507 | 90,507 |
| – Amortisation and depreciation | 90,538 | – | (90,538) | – |
| – Gains on impairment of non–current assets | (31) | – | 31 | – |
| – Loss from disposal of non–current assets | 1,041 | 21 | – | 1,062 |
| – Interest costs | 19,255 | – | – | 19,255 |
| – Interest income | (12,750) | – | – | (12,750) |
| – Fair value gains on derivative financial instruments | – | – | (901) | (901) |
| – Gains from changes in the fair value of the financial instruments | (901) | – | 901 | – |
| – Increase in provisions | 890 | (234) | – | 656 |
| – Share of profit of subsidiaries | – | – | (17,739) | (17,739) |
| – Income from investments in subsidiaries | (17,739) | – | 17,739 | – |
| – Unrealised losses on currency translation differences | – | – | 27 | 27 |
| – Losses from exchange rate fluctuations | 27 | – | (27) | – |
| **Operating profit before working capital adjustments** | **184,374** | **(1,045)** | **–** | **183,329** |
| Decrease in inventories | 354 | – | – | 354 |
| Decrease in trade and other receivables | – | – | 21,670 | 21,670 |
| Decrease in receivables | 21,670 | – | (21,670) | – |
| Decrease in trade and other payables | – | – | (28,015) | (28,015) |
| Decrease in payables | (28,015) | – | 28,015 | – |
| **Cash generated from operating activities** | ***178,383*** | ***(1,045)*** | **–** | ***177,338*** |
| Interest paid | (19,740) | – | – | (19,740) |
| Interest received | 12,633 | – | – | 12,633 |
| Repaid corporate income tax and real estate tax | 3,521 | 1,045 | – | 4,566 |
| **Net cash flows from operating activities** | **174,797** | **–** | **–** | **174,797** |

| | Local GAAP for the 31/12/2015 | Remea–surements | Positions reclassified | IFRS for the 31/12/2015 |
|---|---|---|---|---|
| **Cash flows from investing activities** | | | | |
| Loans issued to subsidiaries | (165,573) | – | – | (165,573) |
| Repayment of loans issued to subsidiaries | 118,770 | – | – | 118,770 |
| Purchase of intangible assets and property, plant and equipment | (74,284) | – | 785 | (73,499) |
| Proceeds from sale of non–current assets | 785 | – | (785) | – |
| Proceeds from investments in subsidiaries | 17,739 | – | – | 17,739 |
| Proceeds from redemption of held–to–maturity financial assets | – | – | 69 | 69 |
| Proceeds from the disposal of shares and bonds | 69 | – | (69) | – |
| **Net cash flows used in investing activities** | **(102,494)** | **–** | **–** | **(102,494)** |
| **Cash flows from financing activities** | | | | |
| Proceeds from issued debt securities (bonds) | 74,893 | – | – | 74,893 |
| Proceeds on borrowings from financial institutions | 30,000 | – | – | 30,000 |
| Repayment of borrowings | (132,864) | – | – | (132,864) |
| Dividends paid to equity holder of the Company | (31,479) | – | – | (31,479) |
| **Net cash flows used in financing activities** | **(59,450)** | **–** | **–** | **(59,450)** |
| | | | | |
| **Net increase in cash and cash equivalents** | **12,853** | **–** | **–** | **12,853** |
| Cash and cash equivalents at the beginning of the year | 88,966 | – | – | 88,966 |
| **Cash and cash equivalents at the end of reporting year** | **101,819** | **–** | **–** | **101,819** |

# 3. FINANCIAL RISK MANAGEMENT

## 3.1. Financial risk factors

The Company’s activities expose it to a variety of financial risks: market risk (including currency risk, fair value and cash flow interest rate risk), credit risk, pricing risk and liquidity risk. The Company’s overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company’s financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

Risk management (except for pricing risk) is carried out by the Latvenergo AS Treasury department (the Company’s Treasury) according to the Financial Risk Management Policy approved by the Management Board of Latvenergo AS. The Company’s Treasury identifies, evaluates and hedges financial risks in close co–operation with the Company’s operating units. The Management Board of Latvenergo AS by approving the Financial Risk Management Policy provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, foreign exchange risk, liquidity risk, and credit risk, use of financial instruments and investment of excess liquidity. Pricing risk management is carried out by the Electricity Trading department of Latvenergo AS according to Electricity Wholesale Regulation approved by the Company’s Management Board.

**Financial assets by categories:**

| | Notes | Loans and receivables | Derivatives used for hedging | Financial assets at fair value through the profit or loss | Held–to–maturity assets |
|---|---|---|---|---|---|
| | | EUR’000 | EUR’000 | EUR’000 | EUR’000 |
| **Financial assets as of 31 December 2016** | | | | | |
| Trade receivables, net | 16 a | 111,541 | – | – | – |
| Loans to subsidiaries | 23 g | 622,704 | – | – | – |
| Other non–current receivables | | 977 | – | – | – |
| Accrued income and other current financial receivables | 16 b | 1,951 | – | – | – |
| Derivative financial instruments | 20 c, l | – | 2,154 | 3,980 | – |
| Held–to–maturity financial assets | 20 a | – | – | – | 20,554 |
| Cash and cash equivalents | 17 | 181,197 | – | – | – |
| | | **918,370** | **2,154** | **3,980** | **20,554** |

| | Notes | Loans and receivables | Derivatives used for hedging | Financial assets at fair value through the profit or loss | Held–to–maturity assets |
|---|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Financial assets as of 31 December 2015** | | | | | |
| Trade receivables, net | 16 a | 100,806 | – | – | – |
| Loans to subsidiaries | 23 g | 624,577 | – | – | – |
| Other non–current receivables | | 1,706 | – | – | – |
| Accrued income and other current financial receivables | 16 b | 2,726 | – | – | – |
| Held–to–maturity financial assets | 20 a | – | – | – | 28,468 |
| Cash and cash equivalents | 17 | 101,819 | – | – | – |
| | | **831,634** | **–** | **–** | **28,468** |
| **Financial assets as of 1 January 2015** | | | | | |
| Trade receivables, net | 16 a | 126,728 | – | – | – |
| Loans to subsidiaries | 23 g | 577,774 | – | – | – |
| Accrued income and other current financial receivables | 16 b | 1,639 | – | – | – |
| Held–to–maturity financial assets | 20 a | – | – | – | 28,528 |
| Cash and cash equivalents | 17 | 88,966 | – | – | – |
| | | **795,107** | **–** | **–** | **28,528** |

**Financial liabilities by categories:**

| | Notes | Derivatives used for hedging | Other financial liabilities at amortised cost | Finansial liabilities at fair value through the profit or loss |
|---|---|---|---|---|
| **Financial liabilities as of 31 December 2016** | | EUR'000 | EUR'000 | EUR'000 |
| Borrowings | 20 b | – | 778,323 | – |
| Derivative financial instruments | 20 c, I | 11,563 | – | 23 |
| Trade and other payables | 22 | – | 71,197 | – |
| | | **11,563** | **849,520** | **23** |
| **Financial liabilities as of 31 December 2015** | | | | |
| Borrowings | 20 b | – | 782,965 | – |
| Derivative financial instruments | 20 c, I | 12,256 | – | 3,318 |
| Trade and other payables | 22 | – | 61,826 | – |
| | | **12,256** | **844,791** | **3,318** |
| **Financial liabilities as of 1 January 2015** | | | | |
| Borrowings | 20 b | – | 810,681 | – |
| Derivative financial instruments | 20 c, I | 16,333 | – | 4,220 |
| Trade and other payables | 22 | – | 88,663 | – |
| | | **16,333** | **899,344** | **4,220** |

### *a) Market risk*

#### *I) Foreign currencies exchange risk*

The introduction of euro in Latvia as of 1 January 2014 prevented the euro currency risk, which primarily was arising from settlements in foreign currencies for borrowings, capital expenditures and imported electricity. As of 31 December 2016 the Company had borrowings denominated only in euros (Note 20 b).

Management has set up a Financial Risk Management Policy inter alia to manage the Company's foreign currencies exchange risk against functional currency. To manage the Company's foreign currencies exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy is to use forward contracts. Foreign currencies exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency that is not the Company's functional currency.

Latvenergo AS Treasury's Financial Risk Management Policy is to hedge all anticipated cash flows (capital expenditure and purchase of inventory) in each major foreign currency that might create significant currency risk. During 2016 the Company had no capital expenditure project which expected transactions would create significant currency risk.

In 2016 the Company had no certain investments, which were exposed to foreign currency risks. The introduction of euro in Lithuania as of 1 January 2015 prevented the euro currency risk arising from the Company's investment in subsidiary in Lithuania.

***II) Cash flow and fair value interest rate risk***
As the Company has significant floating interest–bearing assets and liabilities exposed to interest rate risk, the Company's financial income and operating cash flows are substantially dependent on changes in market interest rates.

During 2016, if euro interest rates had been 50 basis points higher or lower with all other variables held constant, the Company's income from the cash reserves held at bank for the year would have been EUR 892 thousand higher or lower (2015: EUR 478 thousand).

The Company's cash flow interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Company to a risk that finance costs might increase significantly when interest rates rise up. The Company's policy is to maintain at least 35% of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2–4 years.

Generally, the Company raises long–term borrowings at floating rates and based on the various scenarios, the Company manages their cash flow interest rate risk by using floating–to–fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Thereby fixed rates are obtained that are lower than those available if the Company borrowed at fixed rates directly. Under the interest rate swaps, the Company agrees with other parties to exchange, at specified intervals (primarily semi–annually), the difference between fixed contract rates and floating–rate interest amounts calculated by reference to the agreed notional amounts.

To hedge cash flow interest rate risk the Company has entered into rate swap agreements with total notional amount of EUR 174.2 million (2015: EUR 221.5 million) (Note 21 c, II). As of 31 December 2016 62% of the total Company's borrowings (31/12/2015: 55%; 01/01/2015: 43%) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.1 years (2015: 2.4 years).

The Company analyses its interest rate risk exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and hedging. Based on these scenarios, the Company calculates the impact on profit and loss as well as on cash flows of a defined interest rate shift.

During 2016, if interest rates on euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher with all other variables held constant, the Company's profit for the year net of taxes would have been EUR 1,408 thousand lower (2015: EUR 1,868 thousand lower), while if the rates had been 50 basis points lower – profit for the year net of taxes would have been EUR 917 thousand higher (2015: EUR 1,834 thousand higher).

The Company's borrowings with floating rates do not impose fair value interest rate risk. Derivatives such as interest rate swaps are the only source of fair value interest rate risk.

At 31 December 2016, if short and long term euro interest rates had been 50 basis points higher with all other variables held constant fair value of interest rate swaps would have been EUR 3,238 thousand higher (31/12/2015: EUR 4,126 thousand higher; 01/01/2015: EUR 5,321 thousand higher), which would have been attributable to the Company's Statement of Other Comprehensive Income as hedge accounting item, while if the rates had been 50 basis points lower, fair value of interest rate swaps would have been EUR 3,346 lower (31/12/2015: EUR 4,269 thousand lower; 01/01/2015: EUR 5,321 thousand lower), which would have been attributable to the Company's Statement of Other Comprehensive Income as hedge accounting item.

***III) Price risk***
Price risk is the risk that the fair value and cash flows of financial instruments will fluctuate in the future due to reasons other than changes in the market prices resulting from interest rate risk or foreign exchange risk. The purchase and sale of goods produced and the services provided by the Company under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The most significant price risk is related to purchase of electricity. To hedge the risk related to changes in the price of electricity the Company during 2016 has purchased electricity forward and future contracts (Note 20 c, III).

### *b) Credit risk*
Credit risk is managed at the Latvenergo Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, outstanding receivables. Credit risk exposure in connection with trade receivables is limited due to broad range of the Company's customers. The Company has no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics. Impairment loss has been deducted from gross accounts receivable (Note 16).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 17), trade and other receivables (Note 16), derivative financial instruments (Note 20 c) and held–to–maturity financial assets (Note 20 a).

Assessment of maximum possible exposure to credit risk

| | Notes | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 |
| Trade receivables | 16 a) | 111,541 | 100,806 | 126,728 |
| Loans to subsidiaries | 23 g) | 622,704 | 624,577 | 577,774 |
| Accrued income | 16 b) | 1,024 | 1,148 | 1,176 |
| Other non–current financial receivables | | 977 | 1,706 | – |
| Other current financial receivables | 16 b) | 927 | 1,578 | 463 |
| Cash and cash equivalents | 17 | 181,197 | 101,819 | 88,966 |
| Derivative financial instruments | 20 c) | 6,134 | – | – |
| Held–to–maturity financial assets | 20 a) | 20,554 | 28,468 | 28,528 |
| | | **945,058** | **860,102** | **823,635** |

For banks and financial institutions, independently rated parties with own or parent bank's minimum rating of investment grade are accepted. Otherwise, if there is no independent rating, management performs risk control to assess the credit quality of the financial counterparty, taking into account its financial position, past co–operation experience and other factors. After performed assessment individual credit limits are set based on internal ratings in accordance with principles set by the Financial Risk Management Policy. The basis for estimating the credit quality of financial assets not past due and not impaired is credit ratings assigned by the rating agencies or, in their absence, the earlier credit behaviour of clients and other parties to the contract.

For estimation of the credit quality of fully performing trade receivables two rating categories are used:

- Customers with no overdue receivables,
- Customers with overdue receivables.

Credit limits are regularly monitored.

Credit risk related to cash and short–term deposits with banks is managed by balancing the placement of financial assets in order to maintain the possibility to choose the best offers and to reduce probability to incur losses.

The table below shows the balance of cash and cash equivalents by financial counterparties at the end of the reporting period:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Investment level credit rating* | 173,128 | 96,345 | 63,280 |
| No or non–investment level credit rating | 8,069 | 5,474 | 25,686 |
| | **181,197** | **101,819** | **88,966** |

* investment level credit rating assigned for the parent companies of Baltic banks

No credit limits were exceeded during the reporting period, and the Company's management does not expect any losses due to occurrence of credit risk.

### *c) Liquidity risk*

The Company's policy of liquidity risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Company's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

The Company's management is monitoring rolling forecasts of the Company's liquidity reserve, which comprises of undrawn borrowing facilities (Note 20 b), and cash and cash equivalents (Note 17).

The table below analyses the Company's financial liabilities into relevant maturity groupings based on the settlement terms. The amounts disclosed in the table are the contractual undiscounted cash flows. Contractual undiscounted cash flows originated by the borrowings are calculated taking into account the actual interest rates at the end of the reporting period.

Liquidity analysis (contractual undiscounted cash flows)

| | Less than 1 year | From 1 to 2 years | From 3 to 5 years | Over 5 years | TOTAL |
|---|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| **At 31 December 2016** | | | | | |
| Borrowings from banks | 82,646 | 106,856 | 274,674 | 134,879 | **599,055** |
| Issued debt securities (bonds) | 74,915 | 2,880 | 42,389 | 102,577 | **222,761** |
| Derivative financial instruments | 3,737 | 2,894 | 4,594 | 779 | **12,004** |
| Current financial liabilities (Note 22)* | 71,197 | – | – | – | **71,197** |
| | **232,495** | **112,630** | **321,657** | **238,235** | **905,017** |
| **At 31 December 2015** | | | | | |
| Borrowings from banks | 86,486 | 76,850 | 300,045 | 174,899 | **638,280** |
| Issued debt securities (bonds) | 4,365 | 74,519 | 41,864 | 77,751 | **198,499** |
| Derivative financial instruments | 17,320 | 4,950 | 5,727 | 1,683 | **29,680** |
| Current financial liabilities (Note 22)* | 61,826 | – | – | – | **61,826** |
| | **169,997** | **156,319** | **347,636** | **254,333** | **928,285** |
| **At 1 January 2015** | | | | | |
| Borrowings from banks | 145,876 | 94,580 | 303,461 | 207,390 | **751,307** |
| Issued debt securities (bonds) | 2,940 | 2,940 | 74,900 | 35,980 | **116,760** |
| Derivative financial instruments | 10,704 | 5,351 | 7,029 | 3,146 | **26,230** |
| Current financial liabilities (Note 22)* | 88,663 | – | – | – | **88,663** |
| | **248,183** | **102,871** | **385,390** | **246,516** | **982,960** |

* excluding advances received, tax related liabilities and other current non–financial liabilities

### 3.2. Capital risk management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern as well as to ensure necessary financing for investment program and to avoid breaches of covenants, which are linked to capital structure and are stipulated in the majority of loan agreements.

In order to maintain or adjust the capital structure, the Company may evaluate the amount and timing of raising new debt due to investment programs or initiate new investments in the share capital by shareholder. Also asset revaluation directly influences the capital structure. To comply with loan covenants, the Company monitors capital on the basis of the capital ratio.

This ratio is calculated by dividing the equity by the sum of total assets and nominal value of issued and outstanding financial guarantees. According to the Company's strategy and defined loan covenants as per loan agreements the capital ratio shall be maintained at least at 30% level.

The capital ratio figures were as follows:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Total equity | 2,177,069 | 2,114,900 | 2,047,666 |
| Total assets | 3,204,394 | 3,124,054 | 3,104,592 |
| **Capital Ratio** | **68%** | **68%** | **66%** |

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

### a) Estimates concerning property, plant and equipment

***I) Useful lives of property, plant and equipment***

The Company makes estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at the end of each reporting period and are based on the past experience as well as industry practice. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. As of 31 December 2016, the net book amount of property, plant and equipment of the Company totalled EUR 1.323 million (31/12/2015: EUR 1.345 million; 01/01/2015: EUR 1.361 million), and the depreciation charge for the reporting period was EUR 87.4 million (2015: EUR 87.4 million) (Note 13 a). If depreciation rates were changed by 10%, the annual depreciation charge would change by EUR 8.7 million (2015: EUR 8.7 million).

***II) Recoverable amount of property, plant and equipment***

When the events and circumstances indicate a potential impairment, the Company performs impairment tests for items of property, plant and equipment. According to these tests assets are written down to their recoverable amounts, if necessary. When carrying out impairment tests management uses various estimates for the cash flows arising from the use of the assets, sales, maintenance, and repairs of the assets, as well as in respect of the inflation and growth rates. The estimates are based on the forecasts of the general economic environment, consumption and the sales price of electricity. If the situation changes in the future, either additional impairment could be recognised, or the previously recognised impairment could be partially or fully reversed. Such factors as high maintenance and reconstruction costs, low load of several auxiliaries, comparatively substantial maintenance expense, limited facilities to sell property, plant and equipment in the market and other essential factors have an impact of decreasing of the recoverable amounts. If discount rate used for the purposes of impairment charge calculation would be lower or higher by one per cent point the current year's impairment charge on technological equipment would be by EUR 23.2 million higher or respectively – EUR 25.3 million lower (2015: EUR 29.0 million). Impairment charges recognised during the current reporting year are disclosed in Note 13 d).

***III) Revaluation***

External, certified valuers have performed revaluation for part of the Company's property, plant and equipment (Daugava hydropower plants) by applying the depreciated replacement cost model. Valuation has been performed according to standards on property valuation and *IAS 36, Impairment of assets*, based on current use of property, plant and equipment that is estimated as the highest and best use of these assets. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is calculated as property, plant and equipment instant market value at its current use, taking into account by the replacement cost of existing buildings, machinery and equipment as well as refinements on the said property, plant and equipment decreased by the depreciation expenses and other impairment losses. For property, plant and equipment of Daugava hydropower plants revaluation was performed as of 1 January 2012 and next revaluation is planned in year 2017.

### b) Recoverable amount of trade receivables

The estimated collectability of accounts receivable is assessed on the basis of trade receivables aging analysis according to estimates defined by the Company's management. In case individual assessment is not possible due to the large number of individual balances, receivables are classified into groups of similar credit risk characteristics and are collectively assessed for impairment, using historical loss experience. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The circumstances indicating an impairment loss may include initiated insolvency of the debtor and inability to meet payment terms (point 2.2.13.). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss incurred (Note 16).

### c) Evaluation of effectiveness of hedging instruments

The Company has concluded significant number of forward and future contracts and swap agreements to hedge the risk of the changes in prices of electricity and interest rate fluctuations to which cash flow hedge risk accounting is applied and the gains and losses from changes in the fair value of the effective hedging instruments and items secured against risk are included in respective equity reserve. The evaluation of the effectiveness of the hedging is based on the Company's management estimates with regard to future purchase transactions of electricity and signed variable interest loan agreements. When hedging instruments turn out to be ineffective, gains or losses from the changes in the fair value are recognised in the Company's Statement of Profit or Loss (Note 20 c).

### d) Held–to–maturity financial assets

The management of the Company applies judgement in assessing whether financial assets can be categorised as held–to–maturity at initial recognition, in particular (a) its intention and ability to hold the assets to maturity and (b) whether the assets are quoted in an active market. If the Company fails to keep these investments to maturity other than in certain specific circumstances – for example, selling an insignificant amount or settle a position close to maturity – it will be required to reclassify the entire category as available–for–sale. The investments would therefore be measured at fair value rather than amortised cost. For the estimated fair value of investment securities held–to–maturity as of 31 December 2016 refer to Note 20 a).

Evidence of an active market exists if quoted prices are readily and regularly available from an exchange, dealer, broker, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

## e) Financial investments

The Company has applied judgement in determining that it has a financial investment with 46.30% interest held in the company Pirmais Slēgtais Pensiju Fonds AS that manages closed pension plan in Latvia as investment that has been valued at cost without applying equity method. The Company is only a nominal shareholder as all risks and benefits arising from management of pension plan will accrue to the Company's employees who are members of the pension plan and the Company does not have existing rights that give it the current ability to direct the relevant activities of the investee. Therefore this investment has been determined as financial investment in Pirmais Slēgtais Pensiju Fonds AS and not as investment in associate.

## f) Fair value estimation for financial instruments

The following table presents the Company's financial assets and liabilities that are measured at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2),
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

| As of 31 December 2016 | Notes | Level 1 | Level 2 | Level 3 | Total balance |
|---|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Assets** | | | | | |
| Financial assets at fair value through profit or loss: | | | | | |
| – Electricity trading derivatives | 20 c, III | – | 3,980 | – | **3,980** |
| Electricity trading derivatives used for hedging | 20 c, III | – | 2,154 | – | **2,154** |
| **Total assets** | | **–** | **6,134** | **–** | **6,134** |
| **Liabilities** | | | | | |
| Financial liabilities at fair value through profit or loss: | | | | | |
| – Electricity trading derivatives | 20 c, III | – | 23 | – | **23** |
| Interest rate derivatives used for hedging | 20 c, II | – | 11,563 | – | **11,563** |
| **Total liabilities** | | **–** | **11,586** | **–** | **11,586** |

| As of 31 December 2015 | Notes | Level 1 | Level 2 | Level 3 | Total balance |
|---|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Liabilities** | | | | | |
| Financial liabilities at fair value through profit or loss: | | | | | |
| – Electricity trading derivatives | 20 c, III | – | 2,558 | – | **2,558** |
| – Interest rate derivatives | 20 c, II | – | 760 | – | **760** |
| Interest rate derivatives used for hedging | 20 c, II | – | 12,256 | – | **12,256** |
| **Total liabilities** | | **–** | **15,574** | **–** | **15,574** |

| As of 1 January 2015 | Notes | Level 1 | Level 2 | Level 3 | Total balance |
|---|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Liabilities** | | | | | |
| Financial liabilities at fair value through profit or loss: | | | | | |
| – Electricity trading derivatives | 20 c, III | – | 2,112 | – | **2,112** |
| – Interest rate derivatives | 20 c, II | – | 2,108 | – | **2,108** |
| Interest rate derivatives used for hedging | 20 c, II | – | 16,333 | – | **16,333** |
| **Total liabilities** | | **–** | **20,553** | **–** | **20,553** |

## g) Recognition of connection service fees

Connection and other service fees are recognised as income over the estimated customer relationship period, which is 20 years. The estimated customer relationship period is based on the Company's Management estimate. Income from connection and other service fees is deferred as an ongoing service is identified as part of the agreement with customers. Thus period over which revenue is recognised is based on Company's Management estimate and is 20 years.

## h) Recognition and revaluation of provisions

As of 31 December 2016, the Company had set up provisions for environmental protection and post–employment benefits totalling EUR 7,924 thousand (31/12/2015: EUR 6,605 thousand; 01/01/2015: EUR 5,715 thousand) (Note 21). The amount and timing of the settlement of these obligations is uncertain. A number of assumptions and estimates have been used to determine the present value of provisions, including the amount of future expenditure, inflation rates, and the timing of settlement of the expenditure. The actual expenditure may also differ from the provisions recognised as a result of possible changes in legislative norms, technology available in the future to restore environmental damages, and expenditure covered by third parties. For revaluation of provisions for post–employment obligations probabilities of retirement in different employees' aging groups as well as variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts) have been estimated. The probabilities and other factors are determined on the basis of previous experience.

## 5. OPERATING SEGMENT INFORMATION

### Operating segments

For segment reporting purposes, the division into operating segments is based on the Company's internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker.

The Company divides its operations into two main operating segments – Generation and Trade and Corporate functions that covers administration and other support services, which are presented separately.

**Generation and trade** comprises the Company's electricity and thermal energy generation operations, electricity sales (including electricity wholesale), customer services and credit control.

**The operations of the Corporate functions** relates to the provision of administrative and support services (information technology & telecommunication services, assets lease and maintenance, corporate management, vehicle fleet management and other services) for Generation and trade segment, other Latvenergo Group entities and other entities in Latvia.

The following table presents revenue, profit information and segment assets and liabilities of the Company's operating segments. Inter–segment revenue is eliminated on consolidation of the Company's revenue.

| | Generation and trade | Corporate functions | TOTAL segments | Adjustments and elimina-tions | The Company's totals |
|---|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Year ended 31 December 2016** | | | | | |
| **Revenue** | | | | | |
| External customers | 464,928 | 48,635 | **513,563** | – | **513,563** |
| Inter–segment | 342 | 23,060 | **23,402** | (23,402) | **–** |
| **Total revenue** | **465,270** | **71,695** | **536,965** | **(23,402)** | **513,563** |
| **Results** | | | | | |
| Amortisation, depreciation and property, plant and equipment impairment loss | (83,168) | (17,367) | (100,535) | – | (100,535) |
| **Segment profit** | **130,840** | **10,231** | **141,071** | **15,219** | **156,290** |
| **Segment assets at the end of the year** | **1,378,969** | **183,921** | **1,562,890** | **1,641,504** | **3,204,394** |
| **Segment liabilities at the end of the year** | **58,318** | **20,453** | **78,771** | **948,554** | **1,027,325** |
| Capital expenditure | 58,248 | 21,665 | **79,913** | – | **79,913** |
| **Year ended 31 December 2015** | | | | | |
| **Revenue** | | | | | |
| External customers | 473,686 | 47,460 | **521,146** | – | **521,146** |
| Inter–segment | 370 | 21,979 | **22,349** | (22,349) | **–** |
| **Total revenue** | **474,056** | **69,439** | **543,495** | **(22,349)** | **521,146** |

| | Generation and trade | Corporate functions | TOTAL segments | Adjustments and elimina-tions | The Company's totals |
|---|---|---|---|---|---|
| **Results** | | | | | |
| Amortisation, depreciation and property, plant and equipment impairment loss | (73,627) | (16,880) | (90,507) | – | (90,507) |
| **Segment profit** | **86,081** | **4,394** | **90,475** | **12,737** | **103,212** |
| **Segment assets at the end of the year** | **1,371,799** | **180,342** | **1,552,141** | **1,571,913** | **3,124,054** |
| **Segment liabilities at the end of the year** | **54,043** | **10,299** | **64,342** | **944,812** | **1,009,154** |
| Capital expenditure | 55,434 | 23,260 | 78,694 | – | 78,694 |
| **As of 1 January 2015** | | | | | |
| Segment assets at the beginning of the year | **1,412,569** | **172,746** | **1,585,315** | **1,519,277** | **3,104,592** |
| Segment liabilities at the beginning of the year | **75,811** | **10,622** | **86,433** | **970,493** | **1,056,926** |

### Adjustments and eliminations

Finance income and expenses, fair value gains and losses on financial assets are not allocated to individual segments as the underlying instruments are managed on the Company's basis. Taxes and certain financial assets and liabilities are not allocated to those segments as they are also managed on the Company's basis.

Capital expenditure consists of additions of property, plant and equipment, intangible assets and investment properties including assets from the acquisition of subsidiaries.

### Reconciliation of profit

| | Notes | 2016 | 2015 |
|---|---|---|---|
| | | EUR'000 | EUR'000 |
| **Segment profit** | | **141,071** | **90,475** |
| Received dividends from subsidiaries | 14 a) | 17,033 | 17,739 |
| Finance income | 10 a) | 12,958 | 14,097 |
| Finance costs | 10 b) | (14,772) | (19,099) |
| **Profit before tax** | | **156,290** | **103,212** |

### Reconciliation of assets

| | Notes | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 |
| **Segment operating assets** | | **1,556,756** | **1,552,141** | **1,585,315** |
| Non–current financial investments | 14 | 817,049 | 817,049 | 817,049 |
| Loans to subsidiaries | 23 f, g) | 622,704 | 624,577 | 580,168 |
| Held–to–maturity financial assets | 20 a) | 20,554 | 28,468 | 28,528 |
| Derivative financial instruments | 20 c) | 6,134 | – | – |
| Other assets and assets held for sale | | – | – | 4,566 |
| Cash and cash equivalents | 17 | 181,197 | 101,819 | 88,966 |
| **The Company's operating assets** | | **3,204,394** | **3,124,054** | **3,104,592** |

### Reconciliation of liabilities

| | Notes | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|---|
| | | EUR'000 | EUR'000 | EUR'000 |
| **Segment operating liabilities** | | **78,771** | **64,342** | **86,433** |
| Deferred income tax liabilities | 11 | 126,260 | 127,899 | 123,102 |
| Borrowings | 20 b) | 778,323 | 782,965 | 810,681 |
| Derivative financial instruments | 20 c) | 11,586 | 15,574 | 20,553 |
| Current income tax liabilities | | 16,549 | 3,630 | – |
| Trade and other payables | | 15,836 | 14,744 | 16,157 |
| **The Company's operating liabilities** | | **1,027,325** | **1,009,154** | **1,056,926** |

### Geographical information on segments

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **Revenue from external customers** | | |
| Baltics | 479,393 | 507,028 |
| Scandinavian countries | 34,170 | 14,118 |
| **Total revenue** | **513,563** | **521,146** |

All non–current assets are located in the Company's country of domicile – Latvia and consist of intangible assets, property, plant and equipment and investment properties.

Revenue from major customer in 2016 amounted to EUR 98,637 thousand (2015: EUR 100,648 thousand) arising from sales by the Generation and trade segment.

## 6. REVENUE

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Electricity supply and electricity services | 386,670 | 381,702 |
| Heat sales | 71,093 | 81,546 |
| Lease and management of real estate | 19,197 | 17,824 |
| Other revenue | 36,603 | 40,074 |
| **TOTAL revenue** | **513,563** | **521,146** |

## 7. RAW MATERIALS AND CONSUMABLES USED

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| ***Electricity:*** | | |
| Purchased electricity | 48,083 | 82,351 |
| Electricity transmission system services costs | 1,009 | 1,045 |
| Fair value (income) / loss on electricity forwards and futures (Note 20 c, III) | (6,515) | 446 |
| **Total electricity costs** | **42,577** | **83,842** |
| Energy resources costs | 131,952 | 157,944 |
| Raw materials, spare parts and maintenance costs | 11,729 | 11,096 |
| **TOTAL raw materials and consumables used** | **186,258** | **252,882** |

## 8. PERSONNEL EXPENSES

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Wages and salaries | 29,375 | 28,486 |
| Expenditure of employment termination | 600 | 1,030 |
| Pension costs – defined contribution plan | 938 | 1,047 |
| State social insurance contributions and other benefits defined in the Collective Agreement | 7,200 | 6,866 |
| Life insurance costs | 1,052 | 892 |
| **TOTAL personnel expenses, including remuneration to the management** | **39,165** | **38,321** |
| **Remuneration to the management:** | | |
| – Wages and salaries | 644 | 523 |
| – Expenditure of employment termination | – | 33 |
| – Pension costs – defined contribution plan | 7 | 17 |
| – State social insurance contributions and other benefits defined in the Collective Agreement | 152 | 58 |
| – Life insurance costs | 8 | 15 |
| **TOTAL remuneration to the management*** | **811** | **646** |
| Number of employees at the end of the year | 1,472 | 1,464 |
| Average number of employees during the year | 1,478 | 1,452 |

* Remuneration to the management includes remuneration to the members of the Management Board of the Company, members of the Supervisory Board and members of Supervisory body – Audit Committee.

## 9. OTHER OPERATING EXPENSES

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Selling expenses and customer services | 5,590 | 6,708 |
| Information technology maintenance | 4,730 | 4,286 |
| Transportation expenses | 2,228 | 2,111 |
| Environment protection and work safety | 3,852 | 4,300 |
| Real estate maintenance and utilities expenses | 6,424 | 5,913 |
| Telecommunications services | 2,303 | 2,290 |
| Real estate tax | 1,073 | 1,045 |
| Public utilities regulation fee | 780 | 732 |
| Subsidised energy tax * | 14,650 | 15,023 |
| Audit fee | 41 | 38 |
| Other expenses | 7,978 | 8,210 |
| **TOTAL other operating expenses** | **49,649** | **50,656** |

* subsidised energy tax according to the "Subsidised energy tax Law" has been introduced for a four–year period as of 1 January 2014 and applies to state support for generators of subsidised electricity (Note 2.2.18.)

## 10. FINANCE INCOME AND COSTS

### *a) Finance income*

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Interest income on bank accounts and deposits | 40 | 33 |
| Interest income on loans to subsidiaries | 10,635 | 11,172 |
| Interest income from held–to–maturity financial assets | 1,414 | 1,544 |
| Fair value gain on interest rate swaps (Note 20 b) | 760 | 1,348 |
| Net gain on issued debt securities (bonds) | 83 | – |
| Net gain from currency exchange rate fluctuations | 26 | – |
| **TOTAL finance income** | **12,958** | **14,097** |

### b) Finance costs

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Interest expense on borrowings | 5,768 | 8,494 |
| Interest expense on issued debt securities (bonds) | 4,701 | 3,748 |
| Interest expense on interest rate swaps | 4,922 | 6,932 |
| Interest expense on borrowings from subsidiaries | 51 | 81 |
| Net losses on redemption of held-to-maturity financial assets | 58 | 60 |
| Net losses on issued debt securities (bonds) | – | 9 |
| Capitalised borrowing costs (Note 13 a) | (780) | (268) |
| Net losses on currency exchange rate fluctuations | – | 27 |
| Other finance costs | 52 | 16 |
| **TOTAL finance costs** | **14,772** | **19,099** |

## 11. INCOME TAX

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Current income tax | 20,331 | 3,630 |
| Deferred income tax | (1,482) | 4,832 |
| **TOTAL income tax** | **18,849** | **8,462** |

The tax on the Company's profit before tax differs from the theoretical amount that would arise if using the tax rate applicable to profits of the Company as follows:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **Profit before tax** | **156,290** | **103,212** |
| Corporate income tax at the statutory rate 15% | 23,444 | 15,482 |
| Expense non–deductible for tax purpose | 115 | 95 |
| Impairment of receivables | 294 | 584 |
| Income from dividends | (2,555) | (2,661) |
| Losses as a result of re–measurement on defined post–employment benefit plan | – | (35) |
| Deferred tax on disposal of property, plant and equipment revaluation reserve | (462) | – |
| Tax discounts on donations | (27) | (141) |
| Other expenses | (80) | (111) |
| Tax incentives for new technological equipment* | (1,880) | (4,751) |
| **TOTAL income tax** | **18,849** | **8,462** |

* increase in the amount of depreciation of property, plant and equipment applying coefficients for additions of property, plant and equipment and calculation of depreciation for tax purposes as defined in article No. 13 of the Law of Corporate Income Tax of the Republic of Latvia

Deferred income tax assets and liabilities are offset in the Company when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same taxation authority.

The movement on the deferred income tax accounts

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **127,899** | **123,102** |
| (Income) credited / expenses charged to the Statement of Profit or Loss | (1,482) | 4,832 |
| Attributable to re–measurement on defined post–employment benefit plan in other comprehensive income | (157) | (35) |
| **Deferred tax liabilities at the end of the year** | **126,260** | **127,899** |

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| ***Deferred tax liabilities:*** | **Accelerated tax depreciation** | |
| **At the beginning of the year** | **129,881** | **130,976** |
| Income charged to the Statement of profit or loss | (2,726) | (1,060) |
| Attributable to re–measurement on defined post–employment benefit plan in other comprehensive income | (157) | (35) |
| **At the end of the year** | **126,998** | **129,881** |
| ***Deferred tax assets:*** | **Accruals / Accrued expenses** | |
| **At the beginning of the year** | **(1,982)** | **(7,874)** |
| Expenses credited to the Statement of profit or loss | 1,244 | 5,892 |
| **At the end of the year** | **(738)** | **(1,982)** |
| **At the end of the year** | **126,260** | **127,899** |

## 12. INTANGIBLE ASSETS

### a) Intangible assets

| | Connection usage and other rights | Software | Assets under development and advance payments | TOTAL |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| **As of 1 January 2015** | | | | |
| Cost | 8,737 | 36,545 | 2,462 | **47,744** |
| Accumulated amortisation | (2,540) | (26,517) | - | **(29,057)** |
| **Net book amount** | **6,197** | **10,028** | **2,462** | **18,687** |
| **Year ended 31 December 2015** | | | | |
| Additions | 17 | 718 | 4,210 | **4,945** |
| Transfers | 2,135 | 4,335 | (6,470) | **–** |
| Disposals* | (643) | – | – | **(643)** |
| Amortisation charge | – | (3,143) | – | **(3,143)** |
| **Closing net book amount** | **7,706** | **11,938** | **202** | **19,846** |
| **As of 31 December 2015** | | | | |
| Cost | 10,888 | 41,588 | 202 | **52,678** |
| Accumulated amortisation | (3,182) | (29,650) | – | **(32,832)** |
| **Net book amount** | **7,706** | **11,938** | **202** | **19,846** |
| **Year ended 31 December 2016** | | | | |
| Additions | 1 | 758 | 1,933 | **2,692** |
| Transfers | – | 1,568 | (1,568) | **–** |
| Disposals* | (746) | – | – | **(746)** |
| Amortisation charge | – | (3,023) | – | **(3,023)** |
| **Closing net book amount** | **6,961** | **11,241** | **567** | **18,769** |
| **As of 31 December 2016** | | | | |
| Cost | 10,796 | 43,912 | 567 | **55,275** |
| Accumulated amortisation | (3,835) | (32,671) | – | **(36,506)** |
| **Net book amount** | **6,961** | **11,241** | **567** | **18,769** |

* amortisation charge of connection usage rights is included in the Company's Statement of profit or loss position 'Other operating expenses'

### b)Greenhouse gas emission allowances

| | 2016 | 2015 |
|---|---|---|
| | Number of allowances | Number of allowances |
| **At the beginning of the year** | **1,220,761** | **1,882,207** |
| Received emission allowances free of charge | 343,330 | 392,255 |
| Purchased emission allowances | 117,400 | 18,000 |
| Used emission allowances | (1,112,682) | (1,053,701) |
| Sold emission allowances | (22,400) | (18,000) |
| **At the end of the year** | **546,409** | **1,220,761** |

Allowances are allocated free of charge in accordance with the law 'On Pollution and Directives of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia' and are recognised as off–balance sheet assets.

As at the end of reporting year the number of allowances in the Company received in 2016 from the State free of charge was 343,330 (2015: 392,255). Therefore their carrying amount as at the end of reporting year was nil (31/12/2015: nil; 01/01/2015: nil).

The fair value of greenhouse gas emission allowances as of 31 December 2016 was EUR 3,579 thousand (31/12/2015: EUR 10,071 thousand; 01/01/2015: EUR 13,740 thousand). For estimation of the fair value of allowances were used closing market prices of NASDAQ OMX commodities exchange on the last trade date on 30 December 2016 – 6.55 EUR/t (30/12/2015: 8.25 EUR/t; 01/01/2015: 7.30 EUR/t).

Received European Union Allowances (EUA) must be used until the end of 2020.

From greenhouse gas emission allowances purchased in 2016 are sold 22.4 thousand (31/12/2015: all purchased allowances sold).

## 13. PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

### *a) Property, plant and equipment*

Net book amounts and movements of property, plant and equipment by groups, including groups of revalued categories (see Note 2.2.9.) are as follows:

| | Land, buildings and facilities | Technology equipment and machinery | Other property, plant and equipment | Assets under construction and advance payments | Property, plant and equipment, TOTAL |
|---|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| **As of 1 January 2015** | | | | | |
| Cost or valuation | 1,827,148 | 928,393 | 138,911 | 26,549 | **2,921,001** |
| Accumulated depreciation and impairment | (950,410) | (499,117) | (104,896) | (5,914) | **(1,560,337)** |
| **Net book amount** | **876,738** | **429,276** | **34,015** | **20,635** | **1,360,664** |
| | | | | | |
| **Year ended 31 December 2015** | | | | | |
| **Opening net book amount** | **876,738** | **429,276** | **34,015** | **20,635** | **1,360,664** |
| Additions | – | 262 | 10,812 | 58,405 | **69,479** |
| Invested in share capital (Note 18)* | 85 | – | – | – | **85** |
| Transfers | 8,328 | 3,431 | 5,124 | (16,883) | **–** |
| Reclassified to investment property held for sale | (97) | – | – | – | **(97)** |
| Disposals | (20) | (381) | (124) | (24) | **(549)** |
| Impairment charge | – | – | – | 31 | **31** |
| Depreciation | (25,911) | (48,229) | (10,803) | – | **(84,943)** |
| **Closing net book amount** | **859,123** | **384,359** | **39,024** | **62,164** | **1,344,670** |
| | | | | | |
| **As of 31 December 2015** | | | | | |
| Cost or valuation | 1,835,378 | 931,181 | 148,126 | 68,046 | **2,982,731** |
| Accumulated depreciation and impairment | (976,255) | (546,822) | (109,102) | (5,882) | **(1,638,061)** |
| **Net book amount** | **859,123** | **384,359** | **39,024** | **62,164** | **1,344,670** |
| | | | | | |
| **Year ended 31 December 2016** | | | | | |
| **Opening net book amount** | **859,123** | **384,359** | **39,024** | **62,164** | **1,344,670** |
| Additions | – | 1 | 8,630 | 64,565 | **73,196** |
| Invested in share capital (Note 18)* | 177 | 7 | – | – | **184** |
| Transfers | 4,231 | 5,561 | 3,474 | (13,218) | **48** |
| Reclassified to investment property | (195) | – | – | – | **(195)** |
| Disposals | (140) | (223) | (10) | (39) | **(412)** |
| Impairment charge | – | (10,140) | – | 24 | **(10,116)** |
| Depreciation | (27,879) | (45,604) | (11,374) | – | **(84,857)** |
| **Closing net book amount** | **835,317** | **333,961** | **39,744** | **113,496** | **1,322,518** |
| | | | | | |
| **As of 31 December 2016** | | | | | |
| Cost or valuation | 1,833,638 | 925,505 | 150,827 | 119,354 | **3,029,324** |
| Accumulated depreciation and impairment | (998,321) | (591,544) | (111,083) | (5,858) | **(1,706,806)** |
| **Net book amount** | **835,317** | **333,961** | **39,744** | **113,496** | **1,322,518** |

* in December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS (in December 2015: real estate in the amount of EUR 85 thousand)

Impairment charge is included in the Company's Statement of Profit or Loss under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

As of 31 December 2016 cost of fully depreciated property, plant and equipment, which are still in use, amounted to EUR 242,479 thousand (31/12/2015: EUR 191,284 thousand).

In 2016 the Company has capitalised borrowing and finance costs in the amount of EUR 780 thousand (2015: EUR 268 thousand) (Note 10 b).

### *b) Investment properties*

Land or a building or part of a building held by the Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business, after decision of the Company's management are initially recognised as investment properties at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses (Note 2.2.8.).

Property, plant and equipment are classified to investment properties held for capital appreciation if adopted decision that those are not furthermore used in operating activities and it is foreseen to gain its value through sale.

**Investment properties**

| Type of property, plant and equipment | Investment properties for lease | Investment properties held for capital appreciation | TOTAL investment properties |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **As of 1 January 2015** | **69,252** | **1,136** | **70,388** |
| Additions | 4,185 | – | **4,185** |
| Reclassified from property, plant and equipment to investment property | 85 | 12 | **97** |
| Disposals | (29) | – | **(29)** |
| Released | – | (365) | **(365)** |
| Impairment charge (change) | – | (235) | **(235)** |
| Depreciation | (2,452) | (26) | **(2,478)** |
| **As of 31 December 2015** | **71,041** | **522** | **71,563** |
| Additions | 3,842 | – | **3,842** |
| Reclassified to investment property held for capital appreciation | (167) | 167 | **–** |
| Reclassified from property, plant and equipment to investment property | 177 | 17 | **194** |
| Disposals | (19) | – | **(19)** |
| Released | – | (373) | **(373)** |
| Impairment charge (change) | – | 187 | **187** |
| Depreciation | (2,539) | (22) | **(2,561)** |
| **As of 31 December 2016** | **72,335** | **498** | **72,833** |

As of 31 December 2016 based on fair value calculations the fair value for investment properties for lease assessed in the amount of EUR 77,548 thousand (31/12/2015: EUR 101,999 thousand; 01/01/2015: EUR 75,892 thousand).

Based on fair value estimations for real estate assets prepared by external, certified valuers the fair value of the investment property held for capital appreciation at the end of 2016 assessed in the amount of EUR 1,572 thousand (31/12/2015: EUR 1,666 thousand; 01/01/2015: EUR 1,903 thousand). As the estimated fair value is higher than assets closing net book amount, investment property is recognised and accounted at acquisition cost, less accumulated depreciation and previously recorded impairment loss.

### *c) Property, plant and equipment revaluation*

Latvenergo AS revalued assets of Daugava hydropower plants as of 1 January 2012. Valuation was done by independent certified valuators by applying the depreciated model, which provides, that the assets value comprises replacement or renewal costs of similar asset at the date of revaluation less the accumulated depreciation and impairment losses. To determine original cost replacement value of the revaluated asset current acquisition or purchase cost is used. Next revaluation is planned in year 2017.

The carrying amounts of revalued categories of property, plant and equipment groups (see Note 2.2.9.) at revalued amounts and their cost basis are as follows:

| | Revalued property, plant and equipment groups* | | | |
|---|---|---|---|---|
| | Buildings and facilities of Daugava HPP's | Technology equipment and machinery of Daugava HPP's | Other equipment of Daugava HPP's | TOTAL revalued PPE |
| | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| | ***At revalued amount:*** | | | |
| **As of 1 January 2015** | | | | |
| Revalued | 1,512,382 | 330,151 | 13,657 | **1,856,190** |
| Accumulated depreciation and impairment | (878,297) | (222,367) | (8,711) | **(1,109,375)** |
| **Revalued net book amount** | **634,085** | **107,784** | **4,946** | **746,815** |
| **As of 31 December 2015** | | | | |
| Revalued | 1,518,751 | 331,399 | 16,106 | **1,866,256** |
| Accumulated depreciation and impairment | (894,413) | (230,654) | (9,338) | **(1,134,405)** |
| **Revalued net book amount** | **624,338** | **100,745** | **6,768** | **731,851** |
| **As of 31 December 2016** | | | | |
| Revalued | 1,515,376 | 324,771 | 15,769 | **1,855,916** |
| Accumulated depreciation and impairment | (907,067) | (229,374) | (9,647) | **(1,146,088)** |
| **Revalued net book amount** | **608,309** | **95,397** | **6,122** | **709,828** |

| | Buildings and facilities of Daugava HPP's | Technology equipment and machinery of Daugava HPP's | Other equipment of Daugava HPP's | TOTAL |
|---|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| ***At historical acquisition amount:*** | | | | |
| **As of 1 January 2015** | | | | |
| Cost | 119,146 | 150,990 | 10,754 | **280,890** |
| Accumulated depreciation and impairment | (36,549) | (108,020) | (9,370) | **(153,939)** |
| **Net book amount** | **82,597** | **42,970** | **1,384** | **126,951** |
| **As of 31 December 2015** | | | | |
| Cost | 125,515 | 152,360 | 13,203 | **291,078** |
| Accumulated depreciation and impairment | (38,798) | (112,259) | (9,672) | **(160,729)** |
| **Net book amount** | **86,717** | **40,101** | **3,531** | **130,349** |
| **As of 31 December 2016** | | | | |
| Cost | 127,520 | 152,449 | 13,030 | **292,999** |
| Accumulated depreciation and impairment | (42,065) | (113,718) | (9,822) | **(165,605)** |
| **Net book amount** | **85,455** | **38,731** | **3,208** | **127,394** |

*please see groups of revaluated property, plant and equipment in Note 2.2.9.

### *d) Impairment*

In 2016 in the Company has been performed impairment evaluation and additional impairment in the amount of EUR 10,140 thousand (2015: nil) was recognised for Riga combined heat and power plants. Additional impairment it is due to the forecasted tighter competition in the Riga heat market, which in turn have a negative impact on the cogeneration electricity output of the Riga combined heat and power plant. Forecasted period is 2017 – 2028 and the terminal value appraisal is included. Revenue stream forecast corresponds to support period and intensity of cogeneration plants set out in regulations by Cabinet of Ministers of the Republic of Latvia No. 221, dated 10 March 2009. The forecast of expenses is based on historical data, the budget approved by the management for 2017, the service maintenance agreements and the annual growth rate of 2.5%. The accumulated impairment as of 31 December 2016 amounted to EUR 103,910 thousand and consists of impairment charge on technological equipment and machinery of the Riga combined heat and power plant (carried in non–revalued technology equipment and machinery) (31/12/2015: impairment charge in the amount of EUR 93,770 thousand on technological equipment and machinery of the Riga combined heat and power plant).

Impairment review performed in accordance with *IAS 36 Impairment of Assets* and based on value in use calculations. The recognised impairment charge is included in the Company's Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'. The cash–generating unit is defined as the assets of Riga combined heat and power plant. Nominal pre–tax discount rate used to determine value in use of cash–generating unit by discounting cash flows is 7.8% (2015: 7.5%). If discount rate used for the purposes of impairment charge calculation would be higher or lower by one per cent point the current year's impairment charge on technological equipment would be by EUR 23.2 million higher or respectively – EUR 25.3 million lower.

For other significant accounting estimates, judgements and sensitivity analysis see Note 4 a, II.

### *e) Leases*

Assets leased to subsidiaries *Latvijas elektriskie tīkli AS* and *Sadales tīkls AS (the Company as lessor)*:

| | *Latvijas elektriskie tīkli AS* | *Sadales tīkls AS* | TOTAL |
|---|---|---|---|
| | EUR'000 | EUR'000 | **EUR'000** |
| **As of 1 January 2015** | | | |
| Investment properties | 27,005 | 42,247 | **69,252** |
| Other property, plant and equipment | 18 | 8,614 | **8,632** |
| **Total** | **27,023** | **50,861** | **77,884** |
| **As of 31 December 2015** | | | |
| Investment properties | 27,207 | 43,834 | **71,041** |
| Other property, plant and equipment | 78 | 12,849 | **12,927** |
| **Total** | **27,285** | **56,683** | **83,968** |
| **As of 31 December 2016** | | | |
| Investment properties | 27,235 | 45,100 | **72,335** |
| Other property, plant and equipment | 79 | 15,457 | **15,536** |
| **Total** | **27,314** | **60,557** | **87,871** |

In order to support operating activities of transmission system Latvenergo AS on 1 April 2011 entered into agreement with subsidiary Latvijas elektriskie tīkli AS for lease of the real estate related to transmission system network infrastructure with duration of five years. Real estate and non–current assets rent for the 2017 is calculated on the basis of the Company's management estimates for the foreseeable value changes of leased assets.

On 1 October 2011 Latvenergo AS invested most of the distribution system assets in its subsidiary Sadales tīkls AS, which continues the management and maintenance of assets. Lease of the real estate related to distribution system network infrastructure for 2017 is calculated on the basis of the Company's management estimates as of the date of preparation of financial statements for the foreseeable value changes of assets as a result of capital investment projects realised by the Company.

All assets had been leased out to Latvijas elektriskie tīkli AS and Sadales tīkls AS under non–cancellable operating lease agreements.

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **Rental income (the Company is the lessor)** | **19,965** | **18,552** |
| of which,<br>Assets lease to Sadales tīkls AS | 12,395 | 11,424 |
| Assets lease to Latvijas elektriskie tīkli AS | 3,594 | 3,530 |
| Other rental income | 3,976 | 3,598 |
| **Rental expense (the Company is the lessee)** | **1,296** | **1,337** |

Future minimum lease receivables under non–cancellable operating lease contracts by due dates (the Company is the lessor):

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| – < 1 year | 17,779 | 16,107 |
| – 1–5 years | 70,163 | 63,712 |
| **TOTAL rental income** | **87,942** | **79,819** |

Future minimum lease payments under non–cancellable operating lease contracts by due dates (the Company is the lessee):

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| – < 1 year | 1,350 | 1,534 |
| – 1–5 years | 6,453 | 7,363 |
| **TOTAL rental expense** | **7,803** | **8,897** |

## 14. NON–CURRENT FINANCIAL INVESTMENTS

The Company's participating interest in (%) in subsidiaries and other non–current financial investments:

| Companies | Country of incorporation | Business activity held | Interest held, % | | |
|---|---|---|---|---|---|
| | | | 31/12/2016 | 31/12/2015 | 01/01/2015 |
| **Subsidiaries** | | | | | |
| Latvijas elektriskie tīkli AS | Latvia | Lease of transmission system assets | 100% | 100% | 100% |
| Sadales tīkls AS | Latvia | Electricity distribution | 100% | 100% | 100% |
| Enerģijas publiskais tirgotājs AS | Latvia | Management of the mandatory procurement process | 100% | 100% | 100% |
| Elektrum Eesti OÜ | Estonia | Electricity supply | 100% | 100% | 100% |
| Elektrum Latvija SIA | Latvia | Electricity supply | 100% | 100% | 100% |
| Elektrum Lietuva, UAB | Lithuania | Electricity supply | 100% | 100% | 100% |
| Liepājas enerģija SIA | Latvia | Thermal energy generation and supply in Liepaja city, electricity generation | 51% | 51% | 51% |
| **Other non–current financial investments** | | | | | |
| Pirmais Slēgtais Pensiju Fonds AS | Latvia | Management of pension plans | 46,30% | 46,30% | 46,30% |
| Rīgas siltums AS | Latvia | Thermal energy generation and supply in Riga, electricity generation | 0,0051% | 0,0051% | 0,0051% |

The Company owns 46.30% of the shares of the closed pension fund Pirmais Slēgtais Pensiju Fonds AS. However, the Company is only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the Company's employees who are members of the pension fund. Therefore, investment in Pirmais Slēgtais Pensiju Fonds AS is valued at cost and equity method is not applied.

### *a) Investments in subsidiaries*

*Movement in investments in subsidiaries:*

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **817,009** | **817,009** |
| **At the end of the year** | **817,009** | **817,009** |

Share of profit of subsidiaries:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **Dividends received:** | | |
| Latvijas elektriskie tīkli AS | 14,880 | 10,662 |
| Sadales tīkls AS | – | 5,225 |
| Elektrum Lietuva, UAB | 528 | 383 |
| Elektrum Eesti OÜ | 192 | 274 |
| Liepājas enerģija SIA | 1,433 | 1,195 |
| | **17,033** | **17,739** |

| Name of the Company | Equity | | | Net profit / (loss) for the year | | Carrying amount of interest from investment | | |
|---|---|---|---|---|---|---|---|---|
| | 31/12/2016 | 31/12/2015 | 01/01/2015 | 2016 | 2015 | 31/12/2016 | 31/12/2015 | 01/01/2015 |
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Subsidiaries** | | | | | | | | |
| Latvijas elektriskie tīkli AS | 221,670 | 204,067 | 199,849 | 6,852 | 14,880 | 185,624 | 185,624 | 185,624 |
| Sadales tīkls AS | 820,552 | 578,943 | 575,299 | 2 | (10,837) | 627,656 | 627,656 | 627,656 |
| Enerģijas publiskais tirgotājs AS | 40 | 40 | 40 | – | – | 40 | 40 | 40 |
| Elektrum Eesti OÜ | 936 | 863 | 945 | 264 | 192 | 35 | 35 | 35 |
| Elektrum Lietuva, UAB | 920 | 906 | 761 | 542 | 529 | 98 | 98 | 98 |
| Liepājas enerģija SIA | 14,458 | 14,112 | 13,327 | 3,159 | 3,126 | 3,556 | 3,556 | 3,556 |
| | **1,058,576** | **798,931** | **790,221** | **10,819** | **7,890** | **817,009** | **817,009** | **817,009** |

### *b) Other non–current financial investments*

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Other non–current financial investments:** | | | |
| Investment in Pirmais Slēgtais Pensiju Fonds AS | 36 | 36 | 36 |
| Investment in Rīgas siltums AS | 4 | 4 | 4 |
| | **40** | **40** | **40** |

## 15. INVENTORIES

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Raw materials and materials | 1,267 | 1,237 | 1,375 |
| Technological combustibles | 8,094 | 8,167 | 8,250 |
| Natural gas | 817 | – | – |
| Allowance for raw materials and materials | (1,060) | (1,027) | (883) |
| Prepayments for inventories* | 16,693 | 11 | – |
| | **25,811** | **8,388** | **8,742** |

* contains prepayment for natural gas in the amount of EUR 16,682 thousand (see Note 23 c)

Movements on allowances for inventories:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **1,027** | **883** |
| Charged to the Statement of Profit or Loss | 33 | 144 |
| **At the end of the year** | **1,060** | **1,027** |

Changes in allowances are included in the Company's Statement of Profit or Loss position 'Raw materials and consumables used'.

## 16. TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES

### *a) Trade receivables, net*

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Receivables** | | | |
| – Electricity trade and electricity services customers | 120,500 | 106,759 | 101,983 |
| – Heating customers | 9,530 | 9,993 | 14,835 |
| – Other trade receivables | 3,086 | 3,546 | 8,491 |
| – Subsidiaries (Note 23 c, d) | 22,602 | 23,930 | 42,696 |
| | **155,718** | **144,228** | **168,005** |
| **Allowances for impaired receivables** | | | |
| – Electricity trade and electricity services customers | (43,674) | (42,844) | (40,573) |
| – Heating customers | (369) | (400) | (363) |
| – Other trade receivables | (134) | (178) | (341) |
| | **(44,177)** | **(43,422)** | **(41,277)** |
| **Receivables, net** | | | |
| – Electricity trade and electricity services customers | 76,826 | 63,915 | 61,410 |
| – Heating customers | 9,161 | 9,593 | 14,472 |
| – Other trade receivables | 2,952 | 3,368 | 8,150 |
| – Subsidiaries (Note 23 c, d) | 22,602 | 23,930 | 42,696 |
| | **111,541** | **100,806** | **126,728** |

There is no significant concentration of credit risk with respect to trade receivables, as the Company has a large number of customers except the major heating customer the net debt of which as of 31 December 2016 amounted to EUR 9,040 thousand (31/12/2015: EUR 9,683 thousand; 01/01/2015: EUR 14,658 thousand).

Electricity supply and electricity services receivables grouped by past due days and calculated impairment loss:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Electricity supply and electricity services receivables:** | | | |
| Fully performing receivables | 69,766 | 55,032 | 55,231 |
| Receivables past due but not impaired: | | | |
| – Receivables past due by 1–45 days | 5,251 | 6,389 | 4,615 |
| Impaired receivables: | | | |
| – Receivables past due by 46–90 days | 1,402 | 1,939 | 630 |
| – Receivables past due by 91–180 days | 2,029 | 2,786 | 569 |
| – Receivables past due by more than 181 day | 15,136 | 11,884 | 10,833 |
| – Individually impaired receivables with scheduled payments* | 26,916 | 28,729 | 30,105 |
| | **120,500** | **106,759** | **101,983** |
| **Allowances for impaired electricity supply and electricity services receivables:** | | | |
| – Receivables past due by 46–90 days | (640) | (970) | (315) |
| – Receivables past due by 91–180 days | (1,387) | (2,096) | (427) |
| – Receivables past due by more than 181 day | (15,136) | (11,884) | (10,833) |
| – Individually impaired receivables with scheduled payments* | (26,511) | (27,894) | (28,998) |
| | **(43,674)** | **(42,844)** | **(40,573)** |
| **Electricity supply and electricity services receivables, net:** | | | |
| Fully performing receivables | 69,766 | 55,032 | 55,231 |
| Receivables past due but not impaired: | | | |
| – Receivables past due by 1–45 days | 5,251 | 6,389 | 4,615 |
| Net impaired receivables: | | | |
| – Receivables past due by 46–90 days | 762 | 969 | 315 |
| – Receivables past due by 91–180 days | 642 | 690 | 142 |
| – Individually impaired receivables with scheduled payments* | 405 | 835 | 1,107 |
| | **76,826** | **63,915** | **61,410** |

* receivables under insolvency process and other individually impaired receivables

Heating and other receivables grouped by past due days and calculated impairment loss:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Heating and other trade receivables:** | | | |
| Fully performing receivables | 11,997 | 12,887 | 22,529 |
| Receivables past due but not impaired: | | | |
| – Receivables past due by 1–30 days | 101 | 50 | 72 |
| Impaired receivables: | | | |
| – Receivables past due by 31–90 days | 31 | 50 | 43 |
| – Receivables past due by more than 91 day | 487 | 553 | 682 |
| | **12,616** | **13,540** | **23,326** |
| **Allowances for impaired heating and other trade receivables:** | | | |
| – Receivables past due by 31–90 days | (16) | (25) | (22) |
| – Receivables past due by more than 91 day | (487) | (553) | (682) |
| | **(503)** | **(578)** | **(704)** |
| **Heating and other trade receivables, net** | | | |
| Fully performing receivables | 11,997 | 12,887 | 22,529 |
| Receivables past due but not impaired: | | | |
| – Receivables past due by 1–30 days | 101 | 50 | 72 |
| Net impaired receivables: | | | |
| – Receivables past due by 31–90 days | 15 | 25 | 21 |
| | **12,113** | **12,962** | **22,622** |

All receivables of the Company's subsidiaries are fully performing receivables.

The Company's management has estimated allowances for impairment of receivables on the basis of aging of trade receivables and by evaluating liquidity and history of previous payments of each significant debtor (see point 2.2.13.). The carrying amount of trade receivables, less allowances for impairment, is assumed to approximate their fair values.

The Company's management assumptions and methodology for estimation of recoverable amount of trade receivables and evaluation of impairment risk are described in Note 4 b.

Receivables credit quality:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Fully performing electricity supply and electricity services receivables:** | | | |
| – customers with no overdue receivables | 53,262 | 42,655 | 47,630 |
| – customers with overdue receivables | 16,504 | 12,377 | 7,601 |
| | **69,766** | **55,032** | **55,231** |
| **Fully performing heating and other receivables:** | | | |
| – customers with no overdue receivables | 11,727 | 12,778 | 22,409 |
| – customers with overdue receivables | 270 | 109 | 120 |
| | **11,997** | **12,887** | **22,529** |

The basis for estimating the credit quality of fully performing trade receivables not due yet and not written down are internal ratings by reference to earlier credit behaviour of clients.

Movements on allowances for impairment of trade receivables are as follows:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **43,422** | **41,277** |
| Receivables written off as uncollectible | (1,294) | (1,871) |
| Allowances for impaired receivables | 2,049 | 4,016 |
| **At the end of the year** | **44,177** | **43,422** |

The charge and release of allowance for impaired trade receivables due to delayed payments have been recorded in the Company's Statement of profit or loss position 'Other operating expenses' as selling expenses and customer services costs (Note 9).

### *b) Other receivables*

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Other current receivables** | | | |
| Accrued income | 1,024 | 1,148 | 1,176 |
| Pre–tax and overpaid taxes | 17 | 18 | 4,644 |
| Other current financial receivables | 927 | 1,578 | 463 |
| Other current receivables | 150 | 318 | 175 |
| | **2,118** | **3,062** | **6,458** |

None of the Company's receivables are secured with pledges or otherwise. The carrying amounts of other receivables are assumed to approximate their fair values.

## 17. CASH AND CASH EQUIVALENTS

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Cash at bank | 173,843 | 86,667 | 35,361 |
| Short–term bank deposits | 7,000 | 10,000 | 52,000 |
| Restricted cash and cash equivalents* | 354 | 5,152 | 1,605 |
| | **181,197** | **101,819** | **88,966** |

* Restricted cash and cash equivalents as of 31 December 2016 consist of the financial security for participating in NASDAQ OMX Commodities Exchange. Financial security is fully recoverable after termination of participation without any penalties, therefore restricted cash is considered as cash equivalent

Cash at bank balances earns daily interest for the Company mostly based on floating interbank deposit rates. Short–term deposits are placed by the Company for different periods between several days and three months depending on the immediate cash needs of the Company and cash flow forecasts. During 2016 the average annual effective interest rate earned on short–term cash deposits was 0.16% (2015: 0.16%), see also Note 3.1.b.

The carrying amounts of cash and cash equivalents are assumed to be approximate to their fair values.

## 18. SHARE CAPITAL

As of 31 December 2016 the registered share capital of Latvenergo AS is EUR 1,288,715 thousand (31/12/2015: EUR 1,288,531 thousand; 01/01/2015: EUR 1,288,446 thousand) and consists of 1,288,715 thousand ordinary shares (31/12/2015: 1,288,531 thousand; 01/01/2015: 1,288,446 thousand) with the nominal value of EUR 1 per share (31/12/2015: EUR 1 per share; 01/01/2015: EUR 1 per share). All shares have been fully paid.

In December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS (in December 2015: real estate in the amount of EUR 85 thousand). The value of real estate was determined by independent certified valuation experts applying depreciated replacement cost model, based on construction or acquisition costs of similar assets. Increase in the share capital was approved by the Latvenergo AS Shareholders' Meeting on 28 November 2016 and registered with the Commercial Register of the Republic of Latvia on 19 December 2016.

## 19. RESERVES, DIVIDENDS AND EARNINGS PER SHARE

### *a) Reserves*

As of 31 December 2016 the Company's reserves are in the amount EUR 650,020 thousand (31/12/2015: EUR 649,779 thousand; 01/01/2015: EUR 645,719 thousand) and consist of the property, plant and equipment revaluation reserve and hedge reserve. The Company cannot distribute as dividends the property, plant and equipment revaluation reserve and hedge reserve.

| | Notes | Non–current assets revaluation reserve | Hedge reserve | TOTAL reserves |
|---|---|---|---|---|
| | | EUR'000 | EUR'000 | **EUR'000** |
| **As of 1 January 2015** | | **662,052** | **(16,333)** | **645,719** |
| Disposal of non–current assets revaluation reserve, net of tax | | (17) | – | **(17)** |
| Gains from fair value changes in derivative financial instruments | 20 c, I | – | 4,077 | **4,077** |
| **As of 31 December 2015** | | **662,035** | **(12,256)** | **649,779** |
| Disposal of non–current assets revaluation reserve, net of tax | | (2,606) | – | **(2,606)** |
| Gains from fair value changes in derivative financial instruments | 20 c, I | – | 2,847 | **2,847** |
| **As of 31 December 2016** | | **659,429** | **(9,409)** | **650,020** |

### *b) Dividends*

The dividends declared to equity holder of the Company for 2015 were EUR 77,413 thousand or EUR 0.06008 per share (2014: EUR 31,479 thousand or EUR 0.02443 per share).

The Management Board of Latvenergo AS proposes to allocate profit of Latvenergo AS in the amount of EUR 90,142 thousand to be paid out in dividends, that consists from Latvenergo AS profit of 2016 in the amount of EUR 73,021 thousand and from retained profit of 2015 in the amount of EUR 17,121 thousand, and the rest of Latvenergo AS profit of 2016 – EUR 64,420 thousand to transfer to Latvenergo AS reserves with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2017. These financial statements do not reflect this amount as a liability as the dividends have not been approved as of 31 December 2016.

The distribution of net profit of Latvenergo AS for the 2016 is subject to a resolution of the Company's Shareholders Meeting.

## 20. FINANCIAL ASSETS AND LIABILITIES

### *a) Held–to–maturity financial assets*

As of 31 December 2016 the entire Company's held–to–maturity financial assets were State Treasury bonds with 5 year and 10 year maturity, which were purchased with the purpose to invest liquidity reserve in the low risk financial instruments with higher yield. During 2016 in association with the disposal of held–to–maturity financial assets are recognised net losses in the amount of EUR 58 thousand (2015: EUR 60 thousand) (Note 10 b). All held–to–maturity financial assets are denominated in euros. The maximum exposure to credit risk at the reporting date is the carrying amount of held–to–maturity financial assets.

As of 31 December 2016 the fair value of held–to–maturity financial assets is greater than the carrying amount by EUR 4,991 thousand (31/12/2015: EUR 5,959 thousand; 01/01/2015: EUR 6,403 thousand). The fair value of financial assets is calculated by discounting their future cash flows and using as discount factor the banks quoted prices of the financial instruments at the end of the reporting period.

Held–to–maturity financial assets carrying amount:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Held–to–maturity financial assets: | | | |
| – current | 3,520 | 7,859 | – |
| – non–current | 17,034 | 20,609 | 28,528 |
| **TOTAL held–to–maturity financial assets** | **20,554** | **28,468** | **28,528** |

### *b) Borrowings*

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Non–current borrowings from financial institutions | 492,286 | 522,117 | 569,014 |
| Issued debt securities (bonds) | 135,405 | 179,705 | 104,803 |
| **TOTAL non–current borrowings** | **627,691** | **701,822** | **673,817** |
| Current portion of non–current borrowings from financial institutions | 78,222 | 78,832 | 134,798 |
| Current portion of issued debt securities (bonds) | 70,075 | – | – |
| Accrued interest on non–current borrowings | 564 | 809 | 1,372 |
| Accrued coupon interest on issued debt securities (bonds) | 1,771 | 1,502 | 694 |
| **TOTAL current borrowings** | **150,632** | **81,143** | **136,864** |
| **TOTAL borrowings** | **778,323** | **782,965** | **810,681** |

Movement in borrowings:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **782,965** | **810,681** |
| Borrowings received | 55,000 | 30,000 |
| Borrowings repaid | (85,441) | (132,864) |
| Change in accrued interest on borrowings and coupon interest liabilities | 24 | 255 |
| Issued debt securities (bonds) | 25,775 | 74,893 |
| **At the end of the year** | **778,323** | **782,965** |

Borrowings by categories of lenders:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| Foreign investment banks | 394,917 | 432,979 | 482,869 |
| Commercial banks | 176,155 | 168,779 | 222,316 |
| Issued debt securities (bonds) | 207,251 | 181,207 | 105,496 |
| **TOTAL borrowings** | **778,323** | **782,965** | **810,681** |

Borrowings by maturity (excluding the effect of derivative financial instruments):

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Fixed rate non–current and current borrowings:** | | | |
| – < 1 year | 71,921 | 1,703 | 1,099 |
| – 1 – 5 years | 152,911 | 172,985 | 70,432 |
| – > 5 years | 100,676 | 74,902 | 34,570 |
| | **325,508** | **249,590** | **106,101** |
| **Floating rate non–current and current borrowings:** | | | |
| – < 1 year (current portion of non-current borrowings) | 78,711 | 79,440 | 135,765 |
| – 1 – 5 years | 247,646 | 289,097 | 372,612 |
| – > 5 years | 126,458 | 164,838 | 196,203 |
| | **452,815** | **533,375** | **704,580** |
| **TOTAL borrowings** | **778,323** | **782,965** | **810,681** |

Borrowings by pricing period (considering the effect of derivative financial instruments):

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| – < 1 year | 362,867 | 432,979 | 465,987 |
| – 1 – 5 years | 264,791 | 168,779 | 230,124 |
| – > 5 years | 150,665 | 181,207 | 114,570 |
| **TOTAL borrowings** | **778,323** | **782,965** | **810,681** |

As of 31 December 2016, as of 31 December 2015 and as of 1 January 2015 the Company had all of its borrowings denominated in euros.

The fair value of current and non–current borrowings with floating rates and twelve-month-fixed rates equals their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Company, and the effect of fair value revaluation is not significant.

***I) Pledges***

The Company's assets are not pledged to secure the borrowings.

***II) Un-drawn borrowing facilities***

As of 31 December 2016 the un–drawn portion of committed non–current credit facilities amounts to EUR 235 million (31/12/2015: EUR 290 million; 01/01/2015: EUR 320 million). This amount includes: EUR 100 million from European Investment Bank and EUR 135 million from banks (agreements concluded in 2014).

As of 31 December 2016 the Company had entered into three overdraft agreements with total notional amount of EUR 34.2 million (31/12/2015: EUR 34.2 million; 01/01/2015: EUR 34.2 million) and in respect of those all conditions precedent had been met. At the end of the reporting year overdrafts were not used.

***III) Weighted average effective interest rate***

During the reporting year the weighted average effective interest rate (including interest rate swaps) on non–current borrowings was 1.90% (2015: 2.40%), weighted average effective interest rate for current borrowings was 0.87% (2015: 0.87%). As of 31 December 2016 interest rates for non–current borrowings in euros were 3, 6 and 12 month EURIBOR+1.10% (31/12/2015: EURIBOR+1.03%; 01/01/2015: EURIBOR+1.14%). At 31 December 2016 the total notional amount of interest rate swap agreements concluded by the Company amounts to EUR 174.2 million (31/12/2015: EUR 221.5 million; 01/01/2015: EUR 320.0 million) and the interest rate was fixed for the initial periods from 6 to 10 years.

***IV) Issued debt securities (bonds)***

The Company in 2012 and 2013 issued bonds in the amount of EUR 70 million with the maturity date – 15 December 2017 (ISIN code – LV0000801090) and in the amount of EUR 35 million with maturity date – 22 May 2020 (ISIN code – LV0000801165) with fixed annual coupon rate for issued bonds – 2.8%. In 2015 and in 2016, Latvenergo AS issued *green bonds* in the total amount of EUR 100 million with the maturity date – 10 June 2022 (ISIN code – LV0000801777) with fixed annual coupon rate for issued bonds – 1.9%. Thus the total nominal amount of issued bonds amounts to EUR 205 million. All issued bonds are quoted in NASDAQ Baltic Stock Exchange. At the end of reporting year the issued debt securities (bonds) are measured at amortised cost.

As of 31 December 2016 the fair value of issued debt securities (bonds) exceeds their carrying amount by EUR 8,293 thousand (31/12/2015: EUR 5,040 thousand; 01/01/2015: EUR 4,898 thousand). The fair value of debt securities (bonds) issued is calculated by discounting their future cash flows and using the banks' quoted prices of the financial instruments at the end of the reporting year as discount factor.

### *c) Derivative financial instruments*

***I) Outstanding fair values of derivatives and their classification***

In the table below outstanding fair values of derivatives are disclosed as follows:

| | Notes | 31/12/2016 | | 31/12/2015 | | 01/01/2015 | |
|---|---|---|---|---|---|---|---|
| | | EUR'000 | | EUR'000 | | EUR'000 | |
| | | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities |
| Interest rate swaps | 20 c, II | – | 11,563 | – | 13,016 | – | 18,441 |
| Electricity forwards and futures | 20 c, III | (6,134) | 23 | – | 2,558 | – | 2,112 |
| **TOTAL outstanding fair values of derivatives** | | **(6,134)** | **11,586** | **–** | **15,574** | **–** | **20,553** |

| | 31/12/2016 | | 31/12/2015 | | 01/01/2015 | |
|---|---|---|---|---|---|---|
| | EUR'000 | | EUR'000 | | EUR'000 | |
| | Assets | Assets | Assets | Liabilities | Assets | Liabilities |
| Non–current | – | 7,946 | – | 8,291 | – | 11,698 |
| Current | (6,134) | 3,640 | – | 7,283 | – | 8,855 |
| **TOTAL fair values of derivative financial instruments** | **(6,134)** | **11,586** | **–** | **15,574** | **–** | **20,553** |

(Gains) / losses on fair value changes as a result of realised hedge agreements:

| | Notes | 2016 | 2015 |
|---|---|---|---|
| | | EUR'000 | EUR'000 |
| **Included in the Consolidated Statement of Profit or Loss** | | | |
| Interest rate swaps | 10 a) | (760) | (1,348) |
| Electricity forwards and futures | 7 | (6,515) | 446 |
| | | **(7,275)** | **(902)** |
| **Included in the Statement of Other Comprehensive Income** | | | |
| Interest rate swaps | 19 a) | (693) | (4,077) |
| Electricity forwards and futures | 19 a) | (2,154) | – |
| | | **(2,847)** | **(4,077)** |

According to IAS 1 a financial liability or asset that is not held for trading purposes should be presented as current or non–current on the basis of its settlement date. Derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months after the end of the reporting period have been classified as non–current assets or liabilities.

***II) Interest rate swaps***

As of 31 December 2016 the Company had interest rate swap agreements with total notional amount of EUR 174.2 million (31/12/2015: EUR 221.5 million; 01/01/2015: EUR 320.0 million). Interest rate swaps are concluded with 6 to 10 year initial maturities and hedged floating rates are 6 month EURIBOR. As of 31 December 2016 fixed interest rates vary from 0.7725% to 4.4925% (31/12/2015 and 01/01/2015: from 0.7725% to 4.4925%).

At the end of the reporting year all of the Company's outstanding interest rate swap agreements or agreements with notional amount of EUR 174.2 million are designated to comply with hedge accounting and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period (31/12/2015: 91% with notional amount of EUR 201.5 million; 01/01/2015: 88% with notional amount of EUR 280.0 million). All contracts are designed as cash flow hedges. It was established that they are fully effective and therefore there is no ineffective portion to be recognised within profit or loss in the Company's Statement of Profit or Loss.

Fair value changes of interest rate swaps:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | EUR'000 | | EUR'000 | |
| | Assets | Liabilities | Assets | Liabilities |
| **Outstanding fair value at the beginning of the year** | **–** | **13,016** | **–** | **18,441** |
| Included in the Statement of Profit or Loss, net (Note 10 a) | – | (760) | – | (1,348) |
| Included in other comprehensive income (Note 19 a) | – | (693) | – | (4,077) |
| **Outstanding fair value at the end of the year** | **–** | **11,563** | **–** | **13,016** |

The main interest rate hedging criteria stated in the Financial Risk Management policy is to ensure average fixed rate duration from 2 to 4 years and fixed rate portion at more than 35% of the Group borrowings. 62% of the Company's borrowings as of 31 December 2016 had fixed interest rates (taking into account the effect from the interest rate swaps) (31/12/2015: 55%; 01/01/2015: 43%), and average duration was 2.2 years (2015: 2.4 years).

***III) Electricity forwards and futures***

As of 31 December 2016 the Company has entered into electricity forward and future contracts with total outstanding volume of 2,195,685 MWh (31/12/2015: 2,880,436 MWh; 01/01/2015: 1,144,162 MWh) and notional value of EUR 36.0 million (31/12/2015: EUR 64.1 million; 01/01/2015: EUR 38.0 million). Electricity forward and future contracts are concluded for the maturities from one quarter to one year during the period from 1 January 2017 to 31 December 2019.

Latvenergo AS enters into electricity future contracts in the Nasdaq Commodities power exchange, as well as concludes electricity forward contracts with other counterparties. Electricity forward and future contracts are intended for hedging of the electricity price risk and are used for fixing the price of electricity purchased in the Nord Pool AS power exchange.

Electricity forward and future contracts with total outstanding volume of 1,626,285 MWh as of 31 December 2016 are designated to comply with hedge accounting treatment (31/12/2015 and 01/01/2015: no such contracts) and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. For the contracts which are ineffective fair value changes are recorded through profit or loss in the Statement of Profit or Loss (see Note 7), and for fully effective contracts fair value gains and losses are included in other comprehensive income (Note 19 a).

Fair value changes of electricity forward and future contracts:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | EUR'000 | | EUR'000 | |
| | Assets | Liabilities | Assets | Liabilities |
| **Outstanding fair value at the beginning of the year** | **–** | **2,558** | **–** | **2,112** |
| Included in the Statement of Profit or Loss (Note 7) | (3,980) | (2,535) | – | 446 |
| Included in other comprehensive income (Note 19 a) | (2,154) | – | – | – |
| **Outstanding fair value at the end of the year** | **(6,134)** | **23** | **–** | **2,558** |

## *d) Fair values and fair value measurement*

In this Note are disclosed the fair value measurement hierarchy for the Company's assets and liabilities.

Quantitative disclosures of fair value measurement hierarchy for assets at the end of the year:

| | Date of valuation | Fair value measurement using | | | |
|---|---|---|---|---|---|
| | | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | TOTAL |
| | | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| **Assets measured at fair value** | | | | | |
| Revalued property, plant and equipment (Note 13 c) | 31/12/2016 | – | – | 709,828 | **709,828** |
| | 31/12/2015 | – | – | 731,851 | **731,851** |
| | 01/01/2015 | – | – | 746,815 | **746,815** |
| *Derivative financial instruments, including:* | | | | | |
| Electricity forwards and futures (Note 20 c, III) | 31/12/2016 | – | 6,134 | – | **6,134** |
| | 31/12/2015 | – | – | – | **–** |
| | 01/01/2015 | – | – | – | **–** |
| **Assets for which fair values are disclosed** | | | | | |
| Floating rate loans to subsidiaries (Note 23 f, g) | 31/12/2016 | – | 100,872 | – | **100,872** |
| | 31/12/2015 | – | 140,996 | – | **140,996** |
| | 01/01/2015 | – | 251,702 | – | **251,702** |
| Fixed rate loans to subsidiaries (Note 23 f, g) | 31/12/2016 | – | 350,398 | – | **350,398** |
| | 31/12/2015 | – | 297,051 | – | **297,051** |
| | 01/01/2015 | – | 218,482 | – | **218,482** |
| Investment properties (Note 13 b) | 31/12/2016 | – | – | 79,120 | **79,120** |
| | 31/12/2015 | – | – | 103,665 | **103,665** |
| | 01/01/2015 | – | – | 77,795 | **77,795** |
| Held–to–maturity financial assets (Note 20 a) | 31/12/2016 | – | 25,545 | – | **25,545** |
| | 31/12/2015 | – | 34,427 | – | **34,427** |
| | 01/01/2015 | – | 34,931 | – | **34,931** |

There have been no transfers for assets between Level 1 and Level 2 during the reporting period.

Quantitative disclosures of fair value measurement hierarchy for liabilities at the end of the year:

| | Date of valuation | Fair value measurement using | | | |
|---|---|---|---|---|---|
| | | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | TOTAL |
| | | EUR'000 | EUR'000 | EUR'000 | **EUR'000** |
| **Liabilities measured at fair value** *Derivative financial instruments, including:* | | | | | |
| Interest rate swaps (Note 20 c, II) | 31/12/2016 | – | 11,563 | – | **11,563** |
| | 31/12/2015 | – | 13,016 | – | **13,016** |
| | 01/01/2015 | – | 18,441 | – | **18,441** |
| Electricity forwards and futures (Note 20 c, III) | 31/12/2016 | – | 23 | – | **23** |
| | 31/12/2015 | – | 2,558 | – | **2,558** |
| | 01/01/2015 | – | 2,112 | – | **2,112** |
| **Liabilities for which fair values are disclosed** | | | | | |
| Issued debt securities (bonds) (Note 20 b, IV) | 31/12/2016 | – | 213,774 | – | **213,774** |
| | 31/12/2015 | – | 184,745 | – | **184,745** |
| | 01/01/2015 | – | 109,701 | – | **109,701** |
| Floating rate borrowings (Note 20 b) | 31/12/2016 | – | 571,083 | – | **571,083** |
| | 31/12/2015 | – | 601,555 | – | **601,555** |
| | 01/01/2015 | – | 704,580 | – | **704,580** |
| Fixed rate borrowings (Note 20 b) | 31/12/2016 | – | – | – | **–** |
| | 31/12/2015 | – | 206 | – | **206** |
| | 01/01/2015 | – | 633 | – | **633** |

There have been no transfers for liabilities between Level 1 and Level 2 during the reporting period.

The fair value hierarchy for the Company's financial instruments that are measured at fair value, by using specific valuation methods, is disclosed in Note 4 f.

Set out below, is a comparison by class of the carrying amounts and fair value of the Group's financial instruments, other than those with carrying amounts which approximates their fair values:

| | Carrying amount | | | Fair value | | |
|---|---|---|---|---|---|---|
| | 31/12/2016 | 31/12/2015 | 01/01/2015 | 31/12/2016 | 31/12/2015 | 01/01/2015 |
| | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 | EUR'000 |
| **Financial assets** | | | | | | |
| Held–to–maturity financial assets | 20,554 | 28,468 | 28,528 | 25,545 | 34,427 | 34,931 |
| *Derivative financial instruments not designated for hedging, including:* | | | | | | |
| – electricity forwards and futures | 3,980 | – | – | 3,980 | – | – |
| *Derivative financial instruments used for hedging, including:* | | | | | | |
| – electricity forwards and futures | 2,154 | – | – | 2,154 | – | – |
| **Financial liabilities** | | | | | | |
| *Interest–bearing liabilities, including:* | | | | | | |
| – issued debt securities (bonds) | 205,480 | 179,705 | 104,803 | 213,774 | 184,745 | 109,701 |
| – floating rate borrowings | 571,083 | 601,555 | 704,580 | 571,083 | 601,555 | 704,580 |
| – fixed rate borrowings | – | 202 | 605 | – | 206 | 633 |
| *Derivative financial instruments not designated for hedging, including:* | | | | | | |
| – electricity forwards and futures | 23 | 2,558 | 2,112 | 23 | 2,558 | 2,112 |
| – interest rate swaps | – | 760 | 2,108 | – | 760 | 2,108 |
| *Derivative financial instruments used for hedging, including:* | | | | | | |
| – interest rate swaps | 11,563 | 12,256 | 16,333 | 11,563 | 12,256 | 16,333 |

The Company's management assessed that cash and short–term deposits, trade receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short–term maturities of these instruments. The fair value of the financial assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The following methods and assumptions were used to estimate the fair values:

a) The fair values of borrowings with floating interest rates are equal their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Company;
b) The borrowings with fixed interest rates had the fixed repayment period and the financial instrument is not traded in the active market; the financial instrument, which is not traded in the active market, the fair value is measured, using valuation techniques. The Company uses various methods and models and make assumptions, which are based on the market conditions regarding the interest rates and other market conditions, existing at the end of reporting period. The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by the Company's credit risk margin;
c) The Company enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The derivative financial instruments are determined by using various valuation methods and models with market observable inputs. The models incorporate the credit quality of counterparties, foreign exchange spot and forward rates; the fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments. The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices for the volume set in the agreements. If counterparty is a bank, calculated fair values of financial instruments are compared to bank's revaluation reports and the bank's calculated fair values of the financial instruments are used in the financial reports;

The fair value of the bonds issued and held–to–maturity financial assets are calculated, based on the bank's quoted prices of the financial instruments at the end of the reporting period.

## 21. PROVISIONS

### *a) Provisions for post–employment benefits*

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **5,445** | **4,510** |
| Current service cost | 457 | 901 |
| Interest cost | 82 | 77 |
| Post–employment benefits paid | (298) | (277) |
| Losses as a result of changes in actuarial assumptions | 890 | 199 |
| Deferred income tax on re–measurement on defined post–employment benefit plan | 157 | 35 |
| **At the end of the year** | **6,733** | **5,445** |

Total charged / credited provisions are included in the Company's Statement of Profit or Loss position 'Personnel expenses' within state social insurance contributions and other benefits defined in the Collective Agreement (Note 8) while income / (losses) as a result of changes in actuarial assumptions - in the Company's Statement of Other Comprehensive Income:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **5,445** | **4,510** |
| Charged to the Statement of Other Comprehensive Income | 889 | 199 |
| Charged to the Statement of Profit or Loss | 399 | 736 |
| **At the end of the year** | **6,733** | **5,445** |

Weighted average discount rate used for discounting benefit obligations in 2016 was 1.50% (2015: 1.71%), considering the market yields on government bonds at the end of the reporting year. The Company's Collective Agreement provides indexation of employees' wages at least at the level of inflation. Long–term inflation determined for 2016 at the level of 3.0% (2015: 3.5%) when calculating non–current post–employment benefits. In calculation of these liabilities also the probability, determined on the basis of previous experience, of retirement in different employees' aging groups was also considered.

A quantitative sensitivity analysis for significant assumptions as of the end of the year is as shown below:

| Assumptions | | Date of valuation | Discount rate | | Future salary changes | | Retirement probability changes | |
|---|---|---|---|---|---|---|---|---|
| | | | 1% increase | 1% decrease | 1% increase | 1% decrease | 1% increase | 1% decrease |
| Impact on provisions for post–employment benefits | EUR'000 | 31/12/2016 | 752 | (611) | 728 | (606) | 800 | (656) |
| | EUR'000 | 31/12/2015 | 540 | (440) | 526 | (438) | 586 | (481) |
| | EUR'000 | 01/01/2015 | 673 | (539) | 674 | (549) | 454 | (379) |

The sensitivity analysis above have been determined based on a method that extrapolates the impact on defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

### *b) Environmental provisions*

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **1,160** | **1,205** |
| Charged to the Statement of Profit or Loss | 31 | (45) |
| **At the end of the year** | **1,191** | **1,160** |

Total charged provisions are included in the Company's Statement of Profit or Loss position 'Other operating expenses' as environment protection and work safety costs. The environmental provision in the amount of EUR 1,191 thousand (31/12/2015: EUR 1,160 thousand; 01/01/2015: EUR 1,205 thousand) represents the estimated cost of cleaning up the Riga combined heat and power plant No. 1 (Riga TEC–1) ash–fields in accordance with the requests made by the regional Environmental Authority of Riga and feasibility study on this project. The amount of the provisions is calculated taking into account the construction cost index using the data from the Central Statistical Bureau of the Republic of Latvia.

## 22. TRADE AND OTHER PAYABLES

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Current financial liabilities:** | | | |
| Payables to subsidiaries (Note 23 c, e) | 34,093 | 33,774 | 51,559 |
| Payables for materials and services | 32,712 | 22,851 | 28,348 |
| Payables for electricity | 465 | 1,089 | 2,811 |
| Accrued expenses | 3,452 | 3,728 | 4,416 |
| Other financial current payables | 475 | 384 | 1,529 |
| **TOTAL current financial liabilities** | **71,197** | **61,826** | **88,663** |
| | | | |
| **Current non–financial liabilities:** | | | |
| State social security contributions and other taxes | 5,583 | 4,316 | 5,918 |
| Advances received | 7,205 | 3,642 | 193 |
| Other current payables | 1,584 | 1,505 | 1,313 |
| **TOTAL current non–financial liabilities** | **14,372** | **9,463** | **7,424** |
| | | | |
| **TOTAL trade and other payables** | **85,569** | **71,289** | **96,087** |

The carrying amounts of trade and other financial payables are assumed to approximate their fair values.

## 23. RELATED PARTY TRANSACTIONS

The Company and, indirectly, its subsidiaries are controlled by the Latvian state. Related parties of the Company are Shareholder of the Company who controls or who has significant influence over the Company in accepting operating business decisions, members of Management board and Supervisory board of the Company, members of Supervisory body – Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

Trading transactions taking place under normal business activities with the Latvian government including its departments and agencies and transactions between state–controlled entities and providers of public utilities, for which the *IAS 24* exemptions have been applied and which do not represent a significant portion of a type of transaction, are excluded from the scope of related party disclosures.

Quantification of transactions with those related parties is impossible due to broad range of the Company's customers.

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| ***a) Income from transactions with related parties:*** | | |
| – subsidiaries | 172,522 | 174,296 |
| | **172,522** | **174,296** |
| ***b) Expenses from transactions with related parties:*** | | |
| – subsidiaries | 360,421 | 351,719 |
| | **360,421** | **351,719** |
| *including expenses from transactions with related parties recognised in net amount through profit or loss :* | | |
| *– Sadales tīkls AS* | *346,753* | *339,379* |
| *– Enerģijas publiskais tirgotājs AS* | *534* | *584* |
| | ***347,287*** | ***339,963*** |

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| ***c) Balances at the end of the year arising from sales/purchases of goods and services:*** | | | |
| **Prepayments for inventories:** | | | |
| – subsidiaries (Note 15)* | 16,682 | – | – |
| | **16,682** | **–** | **–** |
| **Trade receivables:** | | | |
| – subsidiaries (Note 16 a) | 14,851 | 14,863 | 38,945 |
| | **14,851** | **14,863** | **38,945** |
| **Trade payables:** | | | |
| – subsidiaries (Note 22) | 33,267 | 32,822 | 38,763 |
| – other related parties** | 98 | 99 | 125 |
| | **33,365** | **32,921** | **38,888** |

* Prepayment to the subsidiary Elektrum Eesti OÜ
** Pirmais Slēgtais Pensiju fonds AS

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| ***d) Accrued income raised from transactions with related parties:*** | | | |
| – for goods sold / services received from subsidiaries (Note 16 a) | 5,581 | 6,881 | 1,357 |
| – for interest received from subsidiaries (Note 16 a) | 2,170 | 2,186 | 2,394 |
| | **7,751** | **9,067** | **3,751** |
| ***e) Accrued expenses raised from transactions with related parties:*** | | | |
| – for purchased goods / received services from subsidiaries (Note 22) | 826 | 952 | 12,796 |
| | **826** | **952** | **12,796** |

The Company has not incurred write–offs of trade payables and receivables from transactions with related parties, as all debts are recoverable.

Receivables and payables with related parties are current balances for services and goods. None of the amounts at the end of the reporting year are secured.

In 2016 remuneration to the Company's management that includes remuneration to the members of the Management Board, members of the Supervisory Board and members of the Supervisory body of the Company – Audit Committee, including salary, social insurance contributions and payments to pension plan and is amounted to EUR 811.5 thousand (2015: EUR 645.6 thousand) and included in the Company's Statement of Profit or Loss position 'Personnel expenses'.

### *f) Non–current loans to related parties*

Concluded non–current borrowing agreements with Latvijas elektriskie tīkli AS:

| Agreement conclusion date | Principal amount of the loan | Interest rate | Maturity date |
|---|---|---|---|
| | EUR'000 | | |
| 01/04/2011 | 97,467 | 6 months EURIBOR + fixed rate | 01/04/2025 |
| 03/09/2013 | 44,109 | fixed rate | 10/09/2023 |
| 10/06/2016* | 156,500 | fixed rate | 10/06/2026 |
| **TOTAL** | **298,076** | | |

* as of 31 December 2016 within the loan agreement issued loan have been disbursed in the amount of EUR 15,000 thousand with the maturity date on 10 June 2026

Total outstanding amount of non–current loans as of 31 December 2016 amounted to EUR 75,229 thousand (31/12/2015: EUR 74,746 thousand; 01/01/2015: EUR 99,800 thousand), including current portion of the loan repayable in 2017 – EUR 12,931 thousand (31/12/2015: EUR 14,517 thousand; 01/01/2015: EUR 25,054 thousand). As of 31 December 2016 for 29% (31/12/2015: 41%; 01/01/2015: 56%) of the loans issued to Latvijas elektriskie tīkli AS was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2016 the effective average interest rate of non–current loans was 2.69% (2015: 2.59%). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Latvijas elektriskie tīkli AS by maturity

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Non–current loan:** | | | |
| – < 1 year | 12,931 | 14,517 | 25,054 |
| – 1 – 5 years | 30,866 | 43,796 | 50,515 |
| – > 5 years | 31,432 | 16,433 | 24,231 |
| | **75,229** | **74,746** | **99,800** |

Concluded non–current borrowing agreements with Sadales tīkls AS

| Agreement conclusion date | Principal amount of the loan | Interest rate | Maturity date |
|---|---|---|---|
| | EUR'000 | | |
| 29/09/2011 | 316,271 | 6 months EURIBOR + fixed rate | 01/09/2025 |
| 06/02/2013 | 42,686 | fixed rate | 10/09/2022 |
| 18/09/2013 | 42,686 | fixed rate | 10/08/2023 |
| 29/10/2014 | 90,000 | fixed rate | 10/09/2024 |
| 20/10/2015 | 90,000 | fixed rate | 21/10/2025 |
| 22/08/2016 | 60,000 | fixed rate | 22/08/2026 |
| **TOTAL** | **641,643** | | |

Total outstanding amount of non–current loans as of 31 December 2016 amounted to EUR 362,376 thousand (31/12/2015: EUR 351,954 thousand; 01/01/2015: EUR 355,669 thousand), including current portion of the loan repayable in 2017 – EUR 48,880 thousand (31/12/2015: EUR 49,578 thousand; 01/01/2015: EUR 91,581 thousand). As of 31 December 2016 for 21% of the loans issued to subsidiary (31/12/2015: 31%; 01/01/2015: 55%) was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2016 the effective average interest rate of non–current loans was 1.96% (2015: 1.95%). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Sadales tīkls AS by maturity

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Non–current loan:** | | | |
| – < 1 year | 48,880 | 49,578 | 91,581 |
| – 1 – 5 years | 220,023 | 200,786 | 173,445 |
| – > 5 years | 93,473 | 101,590 | 90,643 |
| | **362,376** | **351,954** | **355,669** |

### *g) Current loans to related parties*

Financial transactions between related parties have been carried out by using current loans with a target to effectively and centrally manage Latvenergo Group companies' financial resources, using Group accounts. In the reporting period Latvenergo AS issued loans to subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources'. In 2016 the effective average interest rate was 0.55% (2015: 0.89%).

In the reporting period Enerģijas publiskais tirgotājs AS received current loan from Latvenergo AS in accordance with mutually concluded agreement 'On provision of mutual financial resources', using Group accounts. Some cash and cash equivalents received in 2014 has been restricted – received government grant for compensation of the increase of mandatory procurement PSO costs in 2014. Respective permission for use was received in December 2015 and cash in the amount of EUR 29,264 thousand has been deposited into Enerģijas publiskais tirgotājs AS bank account as of 30 December 2015 and as a result of it for Enerģijas publiskais tirgotājs AS has been formed a current loan to Latvenergo AS in the amount of EUR 34,232 thousand, that partly covered received borrowings from Latvenergo AS.

On 31 March 2016 an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS for issue of the current loan in amount of EUR 200,000 thousand to ensure Enerģijas publiskais tirgotājs AS financial resources for the fulfilment of public supplier duties and mandatory procurement process administration. Loan annual interest rate is fixed at 1.000% (2015: 1.259%). Maturity date of the loan is 31 March 2017. Latvenergo AS issued and Enerģijas publiskais tirgotājs AS accepted loan or its part at the end of each month, reassigned Enerģijas publiskais tirgotājs AS current loan liabilities from Latvenergo AS at the end of last calendar day of the current calendar month. As of 31 December 2016 issued, but unpaid net amount of current loan is EUR 129,936 thousand (31/12/2015: EUR 126,490 thousand; 01/01/2015: EUR 76,815 thousand).

Non–current and current loans to related parties:

| | 31/12/2016 | 31/12/2015 | 01/01/2015 |
|---|---|---|---|
| | EUR'000 | EUR'000 | EUR'000 |
| **Non–current loans to subsidiaries** | | | |
| Sadales tīkls AS | 313,497 | 302,376 | 264,088 |
| Latvijas elektriskie tīkli AS | 63,883 | 60,229 | 74,746 |
| **Total non–current loans** | **377,380** | **362,605** | **338,834** |
| **Current portion of non–current loans** | | | |
| Sadales tīkls AS | 48,880 | 49,578 | 91 581 |
| Latvijas elektriskie tīkli AS | 11,345 | 14,517 | 25 054 |
| **Current loans to subsidiaries** | | | |
| Latvijas elektriskie tīkli AS | 3,678 | 13,383 | 10,711 |
| Sadales tīkls AS | 41,651 | 48,540 | 21,463 |
| Elektrum Eesti OÜ | 5,046 | 2,941 | 5,129 |
| Elektrum Lietuva, UAB | 4,788 | 6,523 | 8,187 |
| Enerģijas publiskais tirgotājs AS | 129,936 | 126,490 | 76,815 |
| **Total current loans** | **245,324** | **261,972** | **238,940*** |
| **TOTAL loans to subsidiaries** | **622,704** | **624,577** | **577,774** |

* provisions for interest received from subsidiaries as of 1 January 2015 are reclassified to accrued income raised from transactions with related parties (see Note 23 d)

Movement in loans:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| **At the beginning of the year** | **624,577** | **577,774** |
| Issued current loans (net) | 78,446 | 165,573 |
| Repaid non–current loans | (80,319) | (118,770) |
| **At the end of the year** | **622,704** | **624,577** |

**Interest received from related parties:**

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Interest received | 1,408 | 1,865 |
| | **1,408** | **1,865** |

### *h) Current borrowings from related parties*

Financial transactions between related parties have been carried out by using current loans with a target to effectively and centrally manage Latvenergo Group companies' financial resources, using Group accounts. In the reporting period Latvenergo AS has received borrowings from subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources'. In 2016 the effective average interest rate was 0.55% (2015: 0.89%). At the end of the reporting year Latvenergo AS has no borrowings from related parties (31/12/2015 and 01/01/2015: nil).

Interest paid to related parties:

| | 2016 | 2015 |
|---|---|---|
| | EUR'000 | EUR'000 |
| Interest paid | 51 | 81 |
| | **51** | **81** |

## 24. CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2016 the Company had commitments amounting to EUR 150,1 million (31/12/2015: EUR 187.2 million; 01/01/2015: EUR 106.4 million) for capital expenditure contracted but not delivered at the end of the reporting year.

In 2017 Latvenergo AS has issued support letters to its subsidiaries Enerģijas publiskais tirgotājs AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS acknowledging that its position as 100% shareholder is to ensure that subsidiaries are managed so that they have sufficient financial resources and are able to carry their operations and settle their obligations.

## 25. EVENTS AFTER THE REPORTING PERIOD

On 16 February 2017 international credit rating agency Moody's Investors Service has affirmed the credit rating of Latvenergo AS to Baa2 (stable).

On 31 March 2017 Latvenergo AS entered into an agreement with Enerģijas publiskais tirgotājs AS for a loan issue in the amount up to EUR 200.0 million.

On 3 April 2017 Latvijas Elektriskie tīkli AS, according to decision of the Shareholder dated 22 March 2017, has paid to Latvenergo AS dividends for the year 2016 is amount of EUR 6 852 thousand.

According to Energy Law, since 3 April 2017 natural gas market in Latvia is fully open for all users.

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Financial Statements of the Company for the year 2016.

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# INDEPENDENT AUDITOR'S REPORT

To the shareholder of Latvenergo AS

## Opinion

We have audited the accompanying financial statements of Latvenergo AS (the Company) set out on pages 8 to 61 of the accompanying annual report, which comprise the statement of financial position as at 31 December 2016 and the statement of profit or loss, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2016 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the independence requirements included in the Law on Audit Services of Republic of Latvia that are relevant to our audit of the financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with the Law on Audit Services of Republic of Latvia and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

| Key audit matter | How we addressed the key audit matter |
|---|---|
| **Revenue recognition**<br>During the financial year the Company recognized in the statement of profit or loss the revenue amounting to 513 563 thousand EUR, as disclosed in *Note 6. Revenue*. Accurate revenue recognition is inherently more complex in the energy sector when compared to some other industries due to the large number of the Company's customers, including both residential and corporate customers, and the range of products and services provided to different groups.<br><br>Given the variety of contractual terms with the Company's customers, as well as different revenue streams and product types included in each stream, revenue recognition is considered to be relatively complex and requires, among other things, continual operating effectiveness of controls over the various categories of revenue streams. | We performed following procedures, among others:<br>• we tested a sample of IT dependent manual controls implemented over revenue recognition and measurement for electricity supply and electricity services revenue stream;<br>• we tested relevant IT system controls over revenue recording, calculation of amounts billed to the Company's customers and matching of cash receipts to the Company's customers' accounts;<br>• we obtained external customer confirmations regarding heat sales amounts recognized by the Company;<br>• we performed analytical review procedures by forming an expectation of revenue based on the key performance indicators, including taking into consideration the number and composition of the Company's customers, electricity supply volumes, changes in electricity prices and also comparing the results of our analysis against the prior reporting period and |

Revenue recognition was significant to our audit due to the materiality of revenue to the financial statements and the variety of products and price components included in revenue.

- we tested a sample of revenue transactions near the financial year end for appropriate accounting period.

We also assessed the adequacy of the revenue related disclosures contained in *Note 2.2.25. Revenue recognition, Note 5. Operating Segment Information* and *Note 6. Revenue.*

**Impairment assessment of Riga Combined Heat and Power Plant property, plant and equipment (PPE)**

As at 31 December 2016, the Company has recognized PPE amounting to 1 322 518 thousand EUR reported in the statement of the financial position and disclosed in *Note 13. a) Property, plant and equipment.* The Company performed impairment tests based on the value in use estimation for assets of Riga Combined Heat and Power Plant property, plant and equipment as a separate cost generating unit (CGU). As a result of the impairment test an additional impairment of charge of 10 140 thousand EUR was recorded in the statement of profit or loss in the year 2016.

Since Riga Combined Heat and Power Plant PPE amounts to 550 980 thousand EUR, which corresponds to 17% of total assets the Company recognized in the statement of the financial position as at 31 December 2016, the impairment can have a significant effect on the financial statements of the Company.

Impairment test is based on significant assumptions in relation to selection of discount rate, variable revenue stream forecast in view of legislations regulating cogeneration unit capacity component payments and the terminal value calculation.

Impairment test was significant to our audit as it involves significant management judgements applied in the cash flow forecasts.

We involved our valuation specialists to assist in assessment of the impairment test model, discount rate applied and other significant management assumptions as described.

We discussed with the management the appropriateness of the information and data used in the impairment test. We compared the most significant inputs to the source data. We also compared the amounts used by the management in the cash flow forecasts with the historical results and compared the estimated cash flows with the long term budgets approved by the management.

Finally, we evaluated the adequacy of the Company's disclosures in relation to the impairment test and the outcome of these tests as disclosed in *Note 4. Critical Accounting estimates and judgements sub-section a) II) Recoverable amount of property, plant and equipment* and in *Note 14 d) Impairment.*

**Disclosure and impact to the financial statements as a result of adoption of International Financial Reporting Standards in 2016**

The Company has adopted International Financial Reporting Standards as adopted by the European Union (IFRS) with the date of 1 January 2015 and in year 2016 presented its first set of financial statements prepared in accordance with IFRS. Till the year 2016 financial statements were prepared in accordance with the Law of the Republic of Latvia on Annual Reports. The Company adopted IFRS to meet the provisions outlined in the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia, which states that companies subject to the Law on Financial Instruments Market of the Republic of Latvia must prepare their financial statements in accordance with IFRS.

Upon adoption in 2016, as a result of these changes retrospective adjustments impacted certain statement of financial position, statement of profit or loss, statement of changes in equity and statement of cash flows captions. The Company also disclosed a statement of other comprehensive income.

This was important to our audit due to the magnitude of the change and the significant disclosures required.

We involved technical IFRS specialists to assist us in assessing whether in the adoption of IFRS was in accordance with IFRS requirements. We also assessed the scope of accounting policy changes and the effect of retrospective restatements of comparative information to the financial statements. We performed procedures to ensure that the accounting policies applied by the Company in the year 2016 were consistent with the policies applied in Latvenergo group consolidated financial statements, which have been prepared under IFRS already in the past.

We also assessed the adequacy of the disclosures (*Note 2.3. First–time adoption of IFRS*) regarding this IFRS adoption in the 2016 financial statements to determine whether they are in accordance with IFRS requirements.

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**Other information included in the Company's 2016 Annual Report**

Management is responsible for the other information. The other information comprises the Management Report as set out on pages 4 to 7 of the accompanying annual report, but does not include the financial statements and our auditors report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except as described in the *Other reporting responsibilities in accordance with the legislation of the Republic of Latvia* section of our report.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed and in light of the knowledge and understanding of the Company and its environment obtained in the course of our audit, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

*Other reporting responsibilities in accordance with the legislation of the Republic of Latvia*

We have other reporting responsibilities in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Management Report. These additional reporting responsibilities are beyond those required under the ISAs.

Our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

Based solely on the work required to be undertaken in the course of our audit, in our opinion:

- information given in the Management Report for the financial year for which the financial statements are prepared is consistent with the financial statements, and
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

**Responsibilities of management and those charged with governance for the financial statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

**Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Diāna Krišjāne.

Ernst & Young Baltic SIA
Licence No. 17

Diāna Krišjāne
Chairperson of the Board
Latvian Certified Auditor
Certificate No. 124

Riga,
18 April 2017